E. C. Randall

HOW TO AUDIT

A MANUAL OF INSTRUCTION

Originally prepared for the staff of, and under the supervision of a certified public accountant and member of the American Institute of Accountants.

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Foreword

These instructions on how to perform an audit were originally written as a guide for the staff-members of a well-known New York firm of auditors and public accountants. They are based on the form for financial examinations recommended by the Federal Reserve Bank, and on the methods of auditing found desirable by this firm in its many years of experience.

The book takes for granted a knowledge of accounting and hence as its name implies, attempts only to give specific instructions to the accountant who has to verify the books of a concern and prepare its statement of condition and statement of operations.

The subject falls into four natural sections which the book follows. First is a section covering general rules of conduct for the auditor to follow, both to safeguard his client's interests and to establish the client's confidence in the auditor's ability.

The second section is devoted to instructions covering the conduct of an audit in any manufacturing or merchandising concern.

Section 3 details specific points to be looked for in auditing the books of a business having unusual conditions peculiar to that business, which the general instructions in Section 2 do not cover.

In Section 4 are suggested paragraphs for use in writing the comments of a report. The mere presentation of a financial statement is seldom enough. The auditor who is of most service to his client must make comments upon the statement and the examination, which will not only indicate the scope of the investigation, but will point out changes in accounting or even in the management of the business which the examination shows to be desirable.

The paragraphs shown cover the points which most often require comment in a report. They have been carefully edited to make sure that they say accurately and clearly what needs to be said, and that they are free from the jargon which the unskilled writer in any profession is likely to fall into. As they stand, they are in use by the staff auditors of a firm of the highest standing. Full instructions for using them are given.

In determining the physical shape of the book the publishers had constantly in mind the convenience of those who were to use it. As it is a manual, it will be referred to frequently by the auditor in the course of his examinations.

It is the belief of the publishers that "How to Audit" covers the field completely and in detail and that any well-posted accountant can, with its aid, acquit himself well in handling an audit.

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SECTION 1—CHAPTER I.

GENERAL CONDUCT RULES

REPORTS. The following pages provide a skeleton outline of points to be considered when an audit is undertaken; and the samples of statements are a guide to the preparation of the principal exhibits of the average report.

The character of the reports an auditor renders is of unusual importance to the preservation of his reputation and the continuation of his work with any client. To the ordinary prosperous client—and one seeks particularly to serve prosperous clients—business events follow so rapidly on each others' heels, that the details of the work performed by the auditors soon fade from mind. The reports, however, are kept for years, and may be often referred to. Moreover, though only one or two officers or principals of a business enterprise are apt to come in personal contact with the auditors, the reports may be sent to a great many stockholders, directors and banks.

Because of this possible circulation of reports, the most carefully performed audit, that should redound to the auditor's credit, may instead, bring ridicule upon him through small errors in the figures of a report, or through the careless phrasing of the comments of a report.

The wording of the comments is of unusual importance. The average accountant is not a fluent writer, and repetition of stock phrases tends to deaden the importance of careful work. The natural result is an undesirable shortening of necessary paragraphs or the omission of vital statements.

You will find in section 4 of this book, a number of standard paragraphs, preceded by instructions for using them. The language in them has been carefully chosen and every effort has been made to make the comments complete.

If you maintain an office force the following will be found an economical and effective way to handle the preparation of reports.

When the report is received in the office the office manager first has the comments written out in full. The complete report then goes to the principal executive of the company.

Each section of the report is then stamped to provide space for later initialing, as the work upon the report is completed.

It must first be approved by the executive, as to general form and the order in which it is to be prepared in relation to other unfinished reports. Then it goes to an executive for approval of such paragraphs as have been "written in," because of lack of standard paragraphs to cover the points.

Next it goes to the office manager, who gives it to the individual elected to do the first tasks. The one typing or type-setting then initials it.

Completely typed reports or printer's proofs must then be compared word by word and figure by figure, initials of both comparers being added, when the report is corrected.

Then to provide against careless comparing or accounting errors, all substractions, additions and divisions must be refigured, both when arranged horizontally and vertically.

Lastly, the report is bound, a registry number is applied by pasting a numbered seal to the title leaf, preceding the introductory letter, and the number and name of client entered upon a register. The report is then mailed either "special delivery" or by registered mail.

It has been the practise of the majority of audit companies to draw upon the field staff in event of need, when comparing reports, both because of their superior ability to detect errors in form and in order to expedite the work.

When not occupied on specific work, staff members will be expected to hold themselves in readiness to be called upon by the office manager to assist in comparing completed reports, so that no delay will be encountered in their dispatch to clients.

It is also suggested that reports when finished in the rough, be surrendered as promptly as possible to the office, even if it is known that no work can be done upon them for some time.

PROMISING REPORTS. It is not well for accountants to specify dates for reports without first consulting the office. Unpleasant experiences sometimes occur with clients on this score, and clients are too often lost because of a report which was delayed of necessity beyond the promised date.

SATURDAY AFTERNOON. If the client's office or plant is open Saturday afternoon so that the auditor's work can be done, the customary day should be spent with the client, and

the client should be charged for a full day. If the client's office or plant closes at twelve or one o'clock the staff member obviously can do nothing more. He should, nevertheless, report an entire day against the client. This seems to be the accepted rule with auditing firms, the assumption being that the client pays his own people an entire day's wage, giving them half a day; and as the auditor has become an employee of the client, the same rule applies.

TRAVELING TIME. Full time should be charged to a client, when business hours are used in traveling to his place of business from the home office, and vice versa.

When a staff member leaves the home office at his convenience in the evening, arriving long after the starting hour the next day, the client is naturally indisposed to pay for this wasted time. If, however, a staff member leaves at six o'clock the preceding evening, or before, the time preceding six o'clock and the time from the start of business next morning are properly chargeable to the client, all of the otherwise non-productive time being utilized in an effort to reach the client's place of business. The need for this rule is proved by some of the long trips necessarily made by auditors.

USING THE SLIDE RULE. All auditors might profitably take a leaf out of the book of engineering practise.

We have noticed auditors going over work papers, multiplications and percentages, with an engineer's slide-rule, instead of by long-hand with scratch paper and pencil.

The first impression received was that such auditors were up to date. In a room full of auditors such men would be picked as leaders in the profession.

Not only does a slide-rule or other similar instrument actually save time and make for accuracy, but it also makes a good impression. Therefore we urge every auditor to consider the use of a pocket slide-rule.

WATCH FOR NEW IDEAS. The auditor must make it a point to be progressive. As a profession we are too apt to be self-satisfied and to stand still and not experiment. An unprogressive auditor can never hope to be sucessful in the long run; for soon he would become mediocre, then old-fashioned, and finally a "dead one."

So keep your eyes open and see what competitors are doing, and if you find they have something new which is good, see if you can's adopt it. Meanwhile, keep on trying to think of something new that they have not, so that you can forge ahead.

WORK PAPERS. All work papers should be returned to the office as soon as an engagement has been completed. Frequently errors in reports are discovered when the results are in the office. If the work papers are not immediately available, errors cannot be traced and corrected.

It is especially important that all figures and letters be written distinctly so that they will be legible to the accountant or to anyone else.

Do not use ink in preparing work papers, as much erasing is bound to be necessary.

When more than one accountant is working on an assignment and there is occasion for a distribution of the analytical work, etc., then the individuals should initial their papers so that the office can ascertain the responsibility if necessary.

All working papers should be of uniform size. It is advisable for the accountants to use nothing but standard size blocks of scratch paper for all of their memoranda. Use only one side of the sheet as the writing on the back of the sheet may be overlooked at a critical moment.

During the preliminary stage of the examination the accountant should acquaint himself with the system of accounts upon which he is working. It is essential that he have a list of all the books and records that are examined.

When analyses, etc. are made on separate sheets they should be properly marked by letter or number so they can be readily found on the working sheet.

Any adjustment that the accountant may be called upon to make should be recorded in journal entry form as though the entries were made on the books.

It is also advisable to incorporate these entries when sufficient in number into a schedule making them a necessary part of the report.

SECTION 2—CHAPTER II.

GENERAL INSTRUCTIONS FOR A STATEMENT OF CONDITION AUDIT OF A MANUFACTURING OR MERCHANDISING CONCERN

USING THE EXAMINATION PROGRAM. Every auditor should have an examination program similar to the form shown on pages 6, 7, 8 and 9 before commencing an examination.

The history of an examination should be faithfully recorded in the program, and it should be turned in to the office along with the report to be written; the office will bind the program into the office copy of the report, after the typewritten or printed matter.

If preliminary work is done, and the examination then discontinued, or postponed, the program and work papers should be returned to the office to be filed under the client's name as "work papers." They will then be delivered to the accountant or to his successor, when the examination is re-commenced. Particular care should be taken to show on the program the point to which the work has been carried, so that, if an accountant other than the original examiner continues the work, the same ground will not be covered twice.

Whenever in doubt as to the procedure to be followed in an examination, await the arrival of the Chief Accountant or Assistant Chief Accountant, or, if time is limited, communicate with your office for instructions. Do not express uncertainty as to procedure to the client, who may mistake a justifiable uncertainty as a lack of competency.

The following instructions are a combination of the form for financial examination recommended by the Federal Reserve Bank, and of our own long standing instructions. The terms "balance sheet" and "statement of condition" which are both used by accountants, are interchangeable. As, however, "balance sheet," as a title of the statement, has to recommend it only the fact that custom has established the term, the use of "statement of condition," is preferred as more truly expressing the statement's intent. Similarly, "statement of operations" is preferred to "income and profit and loss account," or "profit

EXAMINATION PROGRAM

Client's name...

Address...

Property to be examined...

Address...

Work to start...

Report promised by..

Supervising accountant must turn report in to office by...............

Days estimated.............Senior..............Junior............

Accountants assigned................As seniors....................

....................................As juniors....................

Work to be undertaken indicated by check mark in column headed do......

Read your "How to Audit" carefully for procedure on various points checked.

	Do	Done by			
1. Plant and equipment:					
A. Based on appraisal?					
B. Examine additions. Are they at cost?					
C. Properly depreciated?					
D. Titles to property examined?					
E.					
F.					
2. Goodwill:					
A. How created?					
B.					
C.					
3. Treasury holdings:					
A. Physically examined?					
B.					
4. Securities owned:					
A. Physically examined?					
B. Correspond with holders outside office.					
C. Appraise					
D.					
5. Sinking Fund:					
A. Being properly set aside?					
B. Properly applied in retiring securities?					
C.					
D.					
6. Inventory:					
A. Count quantities					
B. Examine method of compiling costs					
C. Multiply extensions					
D. Verify additions					
E. Should inventory be depreciated?					
F. Have all materials included in inventory been paid for or have vendors been credited?					
G. Scrutinize inventory beginning of period to prove operating staement accuracy					
H. Verify consigned goods by correspondence					
I. Consigned goods carried at cost					
J.					
L.					

	Do	Done by			
7. Cash:					
A. Reconcile cash and check books with bank statement					
B. Secure certificate of balance from bank					
C. Deposit checks found in drawer, in bank, requesting advice of protest					
D. Count cash on hand					
E. Have an executive approve I.O.U.'s, due bills, advances, etc., on hand					
F. Check checks to cash book, examining signatures and endorsements					
F.					
G. Add Dr. cash book					
G.					
H. Add Cr. cash book					
H.					
I. Examine vouchers for check disbursements					
I.					
J. Examine vouchers for petty cash disbursements					
J.					
K. Post cash book to edger					
K.					
L. Add payroll					
L.					
L.					
M. Extend payroll					
M.					
N. Post payroll totals to entry into general books					
O.					
P.					
8. Accounts receivable:					
A. List with name } Prove with controlling account, if one exists					
B. List by age with name } Prove with controlling account, if one exists					
C. List by machine } Prove with controlling account, if one exists					
D. Correspond with debtors to verify					
D.					
D.					
E. Check replies from debtors					
E.					
E.					
E.					
F. Add sales book					
F.					
G. Post sales book footings to general books					
H. Analyze sales					
H.					
I. Have credit allowances approved by executives					

	Do	Done by			
J. List credit balances separately					
K. Have any accounts been pledged to secure loans?					
L. Take out consignment accounts					
M. List past due accounts and comment on presumable uncollectable accounts					
N.					
O.					
P.					
9. Notes receivable:					
A. List with particulars					
B. Correspond with holders of notes outside of office					
C. Verify by corresponding with makers					
D. Have executive approve notes charged off					
E.					
F.					
G.					
10. Deferred and accrued items:					
A. Figure prepaid and accrued bond interest—separately					
B. Figure prepaid and accrued interest—separately					
C. Figure prepaid or accrued wages					
D. Figure prepaid or accrued taxes					
E. Figure prepaid or accrued rent					
F. Figure prepaid or accrued royalty					
G.					
H.					
I.					
J.					
K.					
L.					
11. Advances:					
A. If large advances have been made to subsidiary concerns, investigate solvency of subsidiary concerns or comment on fact					
12. Capital stock:					
A. Examine minutes for disbursement authority, dividends, etc.					
List stockholders from stock ledger					
C. Check stock transfers and postings to ledger					
D. Examine cancelled certificates for endorsement, cancellation, etc					
E. Prove stubs of outstanding certificates with total aggregate stock outstanding					
F.					
G.					
H.					
I.					
J.					

	Do	Done by			
13. Bonds, Mortgages, etc.:					
A. Examine county records for mortgages on property					
B. Examine and aggregate paid bond coupons					
C. Secure certificate from trustee of mortgage on which bonds are issued, or outstanding, retired bonds, etc.					
D.					
E.					
14. Accounts payable:					
A. List with name..					
B. List by age with name					
C. List by machine					
prove with controlling account if one exists					
D. Correspond with creditors to verify					
D.					
E. Check answers from creditors					
E.					
F. Examine inventory to ascertain if assets are represented by liability for unpaid bills					
G. Add book of original entry of bills					
H. Check postings to general books					
I. Analyze distribution of purchases and expenses					
J. Make record of extravagances					
K.					
L.					
M.					
15. Notes and loans payable:					
A. List each separately with details					
B. Ascertain if contingent liability exists					
C. Correspond to ascertain if amounts shown cover entire indebtedness					
D.					
E.					
General:					
A. Is sufficient insurance carried?					
B. Any unclaimed wages on hand?					
C. Any cumulative dividends not shown?					
D. Any profit sharing arrangement not shown?					
Add general ledger accounts					
F.					
G.					
H.					
I.					
17. Special, bank, insurance company, etc., examinations:					

and loss account," when giving a title to the detailed statement which shows the way of arriving at the profit for the period under review.

A statement of condition audit for a fiscal year or other operating period of an industrial or mercantile corporation or firm comprises a verification of the assets and liabilities, a general examination of the profit and loss account, and, incidentally, an examination of the essential features of the accounting.

Trial balances of the general ledger, both at the beginning and end of the period under review, should be prepared in comparative form, and checked with the ledger. The items in the trial balances should be traced into the statements of condition before the assets and liabilities are verified, to prove among other things, that no contra-asset or liability has been omitted from the accounts, that the assets and liabilities have been grouped in the same manner at the beginning and at the end of the period, and that the statements of condition are in accordance with the books. The disposition of any general ledger assets and liabilities that may have been scrapped, sold, writtent off, or liquidated during the period under review should be traced and noted in the working papers. Furthermore, a general scrutiny of the general ledger should be made to see that any accounts that have been opened and closed during the year, have no bearing on the company's financial position at the close of the fiscal period.

The auditor should obtain a copy of the statements of condition at the beginning and the end of the period to be audited, and should make a comparison between them, so that a comprehensive view may be had by him of the changes in the figures during the period under review. A statement of the disposition of the profits should then be prepared from this comparative statement of condition as a further aid in impressing the meaning of the figures upon the mind of the auditor.

In setting up a comparative statement of condition put the earliest date first.

The verification of assets and liabilities for convenience will be considered in the order in which the items appear in the statement of condition form shown on page 54. This form of statement aims to meet as nearly as possible the requirements and practise of the Federal Reserve Bank.

CHAPTER III.

CURRENT ASSETS

CASH should be counted after banking hours on the last day of the fiscal period to be covered by the audit, and the amount thereof, together with the cash stated to be in the bank, reconciled with the balance shown by the cash book. The cash, notes receivable, and investments must be examined on the same day, so as to make it impossible for a treasurer to make up a shortage in one asset by temporarily withdrawing negotiable funds from another.

In counting the cash on hand, the auditor must see that all customers' checks produced to him as part of the cash balance have been duly entered in the cashbook prior to the close of the period. He should note the dates and descriptions of such checks, and also the dates and descriptions of all advances made from cash which are not recorded on the books.

Certificates, as shown on page 12, as to the cash on deposit on the evening of the closing date must be obtained from the company's banks. They must be secured by, or mailed directly to, the auditor at his home office. A stamped, self-addressed envelope should be enclosed for the purpose. The balances as shown by the certificates of balance must be reconciled with those shown on either the cashbook, the checkbook stubs, or bank registers, taking into consideration outstanding checks.

In verifying the outstanding checks the only safe and satisfactory way to prove their accuracy is to compare the credit side of the cash book from the last day of the fiscal period backward, item by item, with the checks returned from the bank for such period as may be necessary to account for all current outstandings. Any old checks not yet cashed by banks should be made the subject of special inquiry. When this work is completed, a list of the outstanding checks so ascertained should be prepared, showing the dates of the checks, and compared with the actual checks returned from the bank, at a later date, and any not so returned should be specially

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

......................19....

....

....

Dear Sir:

We are engaged upon an audit of the accounts of....
....
and it appears that (at the close of business) on............
........................19.... there was on deposit with
you to {his / their} credit the sum of $.............

Will you kindly advise us direct whether the aforesaid balance is correct.

Very truly yours,
JOHN BLANK & COMPANY, Inc.
By........................

Please furnish the above information as requested.

....

No............

No............ ....19....

John Blank & Company., Inc.,
New York

Dear Sirs:

This is to certify that there was on deposit in this bank (at the close of business) on......................19....
to the credit of..
the sum of ....Dollars.
$.............. ....
By........................

investigated. Special care is necessary to see that no checks for cash purposes are drawn at the close of the period and entered in the next period.

Where the currency and bank transactions are kept together in the cashbook, and the auditor does not count the cash until a date subsequent to the close of the fiscal year, he must, in addition to verifying the bank balances as of the close of the year, verify them as of the date of the count of cash. This is absolutely essential when it is considered that, although the cash on hand which forms only part of the balance at the date of the count may be correct, it does not follow that the total cash is correct. It is essential that the date upon which the cash is counted should be recorded, in event of a discrepancy arising after our departure.

Unfortunately, in all but a few cases, it is not practicable to verify cash by being present on the last day of the period being investigated. So many companies close their books on December 31st, that it becomes physically impossible to visit all clients on that day. However, the method described in the preceding paragraph is the one generally to be followed.

When the receipts are shown in the cash books as being deposited in the bank on the last day of the fiscal period, but are included in the reconciliation statement on account of their not being paid into the bank until the next day, the auditor should ask the banks to acknowledge the later receipt of the deposit, and to advise if any of the checks prove worthless.

The deposits shown in the pass books, or upon the banks' monthly statements, should be checked in detail for the last two or three days of the fiscal period, from the books, to prove that they were composed of bona fide checks, and that no check drawn by the company was deposited in a bank without being credited to the bank on which it was drawn, prior to the close of the fiscal period.

So that the auditor may satisfy himself that deposits are promptly made in a bank each day, and that the same checks are paid into bank as received, it is advisable to call for a number of deposit slips and compare them with the receipts as shown by the cash book for the days on which the deposits are made. To make such verifications accurate, the deposit slips should be obtained from the banks.

The senior accountant must use his discretion as to the extent of the cash examination. The method we describe is

intended to secure an absolute check, but to do so requires considerable research, not always justified or acceptable to our clients.

Where irregularities are suspected, the most thorough check must of course be obtained.

When it is the practise of a company to pay all of its cash receipts into the bank, they should be compared and reconciled with the total deposits as shown by the bank books, and similarly the disbursements should be reconciled with the total checks drawn.

Outstanding checks not examined at a previous audit on account of not having been returned by the banks must be called for and traced into the cash book at the beginning of the current audit.

The balance on hand in the petty cash fund should be represented by either cash or vouchers. All tickets, due bills, or advance memoranda, should be presented to the proper authority for approval (an officer, if a corporation; a firm member, if a partnership). Checks carried as a part of the balance should be followed to a proof of their having been deposited in the bank, or vouched for by the proper authority.

All cases where the cash items amount to a very large sum, should be reported to the accountant in charge and left to his discretion whether they should be listed and included in our final report.

BANK OVERDRAFT. Where a concern has several banks of deposit, and any bank account is overdrawn, the net amount on deposit should not be presented in our statement of condition. The total cash on deposit should be shown on the asset side of our statement, and the overdraft as a liability under current liabilities.

NOTES RECEIVABLE. A list of notes receivable outstanding at the end of a fiscal period should be prepared showing the dates the notes are made, the customers' names, the date due, the amounts of the notes and the interest, if any, contained in the notes. If discounted, the name of the discounting bank should be noted and verification obtained from the bank.

The outstanding notes must be carefully examined with the notes receivable records, and with the list prepared by or produced to the auditor, the due dates and the dates of making

the notes being carefully checked, and when notes have been renewed the original dates should be recorded. When notes have been paid since the close of the fiscal year, the cash should be traced into the books of the company, and, when they are in the hands of attorneys or bankers for collection, letters of confirmation should be obtained from the depositaries certifying to that fact.

When notes receivable are discounted by banks the company has a liability therefore which should appear in the statement of condition.

The value of collateral, if any, held for notes should be ascertained, as it frequently happens that the notes are for a greater amount than the value of the collateral.

Notes due by officials and employees as well as received for other than trade transactions must always be stated separately from customers' notes.

Notes due from affiliated concerns must not be included as customers' notes, even though received as a result of trading transactions. Affiliated companies' notes should be shown as a separate item of current assets or as other assets as the circumstances warrant. They may be fairly included in current assets, if the debtor company has ample margin of quick assets over its liabilities, including such notes.

The term "quick assets" is used here in the sense in which it is used in Federal Reserve practise. "Current assets" is used to designate these assets and other assets which, though current, are excluded in determining the eligibility of the paper for Federal Reserve purposes.

The best verification of notes receivable is an acknowledgement by the party named in each note as the payor that the note is a bona fide obligation. Therefore, if time permits, and the client does not object, it is advisable to obtain the maker's written confirmation for each note. The auditor should personally mail the letters, inclosing stamped envelopes for replies addressed direct to his home office.

ACCOUNTS RECEIVABLE. The book-keepers of the accounts receivable ledgers should be asked to draw off lists of the open balances at the end of the fiscal period, and distributions of the total columns should be shown on the lists according to the age of the accounts, e.g., not yet due, less than 30 days past due, and more than 30 days past due. The accounts paid since the

close of the fiscal period should be noted in the lists before taking up the matter of past-due accounts with the credit department, as payment is the best proof that an account was good at the date of the audit.

The totals of the lists of outstanding accounts should agree with the controlling account in the general ledger if separate ledgers are kept. When credit balances appear on customers' accounts they should be shown in the statement of condition as separate items and not deducted from the total of debit balances. Debit balances on the accounts payable ledgers should be treated in the same manner.

The lists must be footed and compared in detail with the customers' accounts in the ledgers.

The composition of outstanding balances should always be examined, as it frequently happens that while a customer may be making regular payments on his account, old items are being carried forward which have been in dispute for a considerable period of time. Such items and accounts which are past due should be taken up with the credit department or some responsible officer, and the correspondence with the customers examined, so that the reserve for bad and doubtful accounts set up by the company shall be sufficient. If such an account has not been established the auditor should nevertheless set up a reserve in the statement so that they will be conservative.

Trade discounts (also so-called "cash discounts," if exceeding 1 per cent) and freight allowances made by the company should be inquired into, and if they have been included in the accounts receivable a reserve for them should be set up in the statement of condition. Also, inquiries should be made regarding customers' claims for reductions in prices and for rebates and allowances on account of defective materials, so that the auditor may make certain that a sufficient reserve has been established.

Careful inquiry must be made as to whether any of the accounts receivable have been hypothecated or assigned, and the sum total of accounts so listed entered as a liability, noting that they are pledged to secure contra-loans.

The auditor should satisfy himself that the bad debts written off have been duly authorized by responsible officials, for bookeepers have been known to write off accounts which have actually been collected in order to cover money diverted into their own pockets.

Accounts due from directors, officers, and employees must appear separately in the statement of condition and not be included as trade accounts. This applies also to deposits as security, guaranties, amounts due for freight claims and other extraordinary items not connected with sales.

Accounts due from affiliated concerns must not be included as customers' accounts, even though arising as a result of trading transactions. Affiliated companies' accounts should be shown as a separate item of current assets, if the debtor company has ample margin of quick assets over its liabilities, including such accounts.

The best verification of an open balance is a confirmation by the customer; therefore, if time permits and the client does not object, it is advisable to circularize the customers with an inquiry form such as is shown on page 18. The auditor should personally see the circulars mailed after comparing them with the lists of outstanding accounts. The stamped envelope for replies sent with the circulars should be addressed direct to the auditor's home office.

In large concerns the system of accounting employed is generally such that it would be almost impossible for accounts to be paid and not correctly credited on the accounts receivable ledgers, but in small concerns, with imperfect systems, such occurrences are quite possible; so much so, in fact, that it is generally admitted that the risk of errors and omissions decreases in direct proportion to an increase in bookkeeping.

INVENTORIES. Under this caption should be included only stocks of goods owned by and under control of the owner. Stocks are often hypothecated, and if this is so the fact should appear in the statement of condition.

In presenting the value of an inventory, it is necessary to comment upon the method by which the inventory was verified. If, as often happens, the auditor is not permitted to verify the inventory, he obtain a certificate, in writing, from an authorized person (an officer, if a corporation; a firm member, if a partnership) to the effect that the quantities are correct and that the value presented is a live inventory cost valuation.

In making a first examination for a new client, test inventories at the beginning and end of the period by percentage of production cost, against sales. Where there is reason to

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

....

....

Dear Sir:

We are engaged upon an audit of the accounts of....
....
and it appears that on....................19.... there was a balance due from you of $............

Will you please advise upon the attached blank if the amount is correct and if not send detail statement to enable us to rectify the error.

This letter should not be construed as a request for payment, as it is only designed to establish the correctness of the books.

Very truly yours,

JOHN BLANK & COMPANY, Inc.

By........................

Please furnish the above information as requested:

....

....

.....................19....

John Blank & Company., Inc.,
New York.

Dear Sirs:

The correct balance due...........................
....
upon...........................19.... was $........

....

....

IMPORTANT

As a necessary part of the periodical examination which we have been requested to make by the Board of Directors of this institution, we ask your kind assistance.

The enclosed statement shows your account as it appears upon the bank's books. Please check it. If we do not hear from you, we will assume the amount shown as a balance to be correct, if, however, a difference exists please communicate with us so that we may investigate and correct error.

Should it be necessary to correspond, please address:

JOHN BLANK & COMPANY, Inc.
New York City
Auditors and Public Accountants

IMPORTANT

We are engaged upon an audit of the accounts of the company sending this statement and it appears upon their books that on the date given there was due fom you the sum shown.

If we do not hear from you, we will assume the amount to be correct, if, however, a difference exists, please communicate with us so that we may investigate and correct error.

This note should not be construed as a request for payment, as it is only designed to establish the correctness of the books.

Should it be necessary to correspond, please address:

JOHN BLANK & COMPANY, Inc.
New York
Auditors and Public Accountants.

question an inventory affecting the profits of the business, this rule should invariably be followed by the auditor.

Material shipped on consignment with no obligation on the part of consignee to pay for it until actual sale is made, should always be included in the inventory at cost of finished product. A record of it should be kept and shown separately from the regular inventory or accounts receivable until the actual sales are made.

Inasmuch as the accuracy of the statement of operations account is absolutely dependent upon the accuracy of the inventories of merchandise at the beginning and end of the period under review, this part of the verification should receive special attention. When a statement of condition audit is being made for the first time, the inventory at the beginning of the period should receive as much attention as that at the end, and the auditor should take every precaution to satisfy himself that both inventories were taken on the same basis.

An acceptable program of audit for inventories follows:

(1) Secure the original stock sheets if they are in existence and carefully test the typewritten copies with them and with tickets, cards, or other memoranda that show the original count.

(2) See that the sheets are certified to or initialed by the persons who took the stock, made the calculations and footings, and fixed the prices, and satisfy yourself that they are dependable and responsible persons. Obtain a clear and detailed statement, preferably in writing, as to the method followed in taking stock and pricing it; also a certificate from a responsible head as to the accuracy of the inventory as a whole.

(3) A thorough test of the accuracy of the footings and extensions should be made, especially of all large items.

(4) The inventories should be compared as far as possible with the stores records, work in process records and finished stock records, as to quantities, prices and values, and any material discrepancy should be thoroughly traced.

(5) Where stock records are kept and no physical inventory is taken at the time of the audit, ascertain when the last physical inventory was taken and compare it with the book records. If no recent comparison is possible, select a few book items of importance and personally compare with the actual stock on hand.

(6) Where no stock records are kept, a physical inventory should be taken, preferably under the general direction of the auditor. After the inventory is completed, he should apply

the same tests to verify its accuracy as if the inventory had been taken before his arrival.

(7) When the cost system of a company does not form a part of the financial accounting scheme there is always a chance that orders may be completed and billed, but not taken out of the work-in-process records. Especially is this the case when reliance is placed on such records to the extent that a physical inventory is not taken at the end of the period to verify the information shown therein. In these cases the sales for the month preceding the close of the fiscal period should be carefully compared with the orders in progress as shown by the inventory, to see that nothing that has been shipped is wrongly included in the inventory. Cost systems which are not co-ordinated with the financial accounts are unreliable and frequently misleading. Special attention should be called to every instance where the cost system is not adequately checked by the results of the financial accounting.

(8) Make certain that purchase invoices for all stock included in the inventory have been entered on the books. Look for post-dated invoices and give special attention to goods in transit.

(9) See that nothing is included in the inventory which is not owned but is on consignment from others. If goods consigned to others are included, see that cost prices are placed thereon, less a proper allowance for loss, damage, or expenses of possible subsequent return. This does not include goods at branches, as the valuing of such stocks will be governed by the same principles as apply at the head office.

(10) Make sure that nothing is included which has been sold and billed, and is simply awaiting shipment.

(11) If duties, freight, insurance, and other direct charges have been added, test them to ascertain that no error has been made. Duties and freight are legitimate additions to the cost price of goods, but no other items should be added except under unusual circumstances. Such items as liquors, piano wood, and others that improve through seasoning, may rightly have interest and insurance added to their value, if the total value per unit does not exceed the market price for materials of equal quality.

(12) To prevent obsolete or damaged stock being carried in the inventory at an excessive valuation, the detailed records for stores, supplies, work in process, finished products, and purchased stock should be examined and a list prepared of inactive

stock accounts. This should be discussed with the company's officials and satisfactory explanations obtained.

(13) The auditor should satisfy himself that inventories are stated at cost or market prices, whichever is the lower at the date of the balance sheet. This test applies to each item in the inventory. No inventory must be passed which has been marked up to market prices and a profit assumed that has not and may never be realized, If the market is higher than cost, it is permissible to state that fact in a footnote on the statement of condition.

(14) It may be found that inventories are valued at the average prices of raw materials and supplies on hand at the end of the period. If so, the averages should be compared with the latest invoices in order to verify the fact that they are not in excess of the latest prices, and also with the trade papers, when market prices are used, to see that they are not in excess of market values.

(15) Make an independent inspection of the inventory sheets to determine whether or not the quantities are reasonable, and whether they accord in particular instances with the average consumption and average purchases over a fixed period. Abnormally large quantities of stock on hand may be the legitimate result of shrewd foresight in buying in a low market, but may, on the other hand, arise from serious errors in stock taking, or may be an over-stock on which a loss has been sustained but not recorded.

(16) Always attempt to check the totals by the "gross profit test" and compare the percentage of gross profit shown with that of previous years. In a business whose average gross profit remains fairly constant this test is a dependable one, because, if the rate of gross profit is apparently not maintained and the discrepancy can not be satisfactorily accounted for by a rise or fall in the cost of production or of the selling price, the difference will usually be due to errors in stock taking. This method was very acceptable before the war, but until normal business conditions are restored, can not be considered as conclusive evidence of irregularities.

(17) The best way to verify the prices at which the work in process is included in the inventory, is to make a general examination and test of the cost system. In a good cost system little difficulty will be found with the distribution of the raw materials, stores, and pay roll, but the distribution of factory

overhead is one that should receive careful consideration, the main points to be kept in view being;

(a) That no selling expense or interest charges are included in the factory overhead, and that only that share of administrative expense pertaining to the factory is included.

(b) That the factory overhead is distributed over the various departments, shops, and commodities on a fair and equitable basis.

(18) No profit should be included in the price of finished products or stock in trade. The price list should be examined to see that the cost prices of stock are below the selling prices after allowing for trade discounts. If they are not, a reserve should be set up on the balance sheet for this loss. If the company takes immediate steps to increase the selling price, however, the amount of this reserve may be limited to the loss on goods which may have been sold since the close of the period to the date of the discovery.

(19) Companies manufacturing on large contracts frequently make partial shipments of orders. The question then arises whether it is permissible to include the profits on these partial shipments in the profit and loss account. As a matter of fact, it is evident that the actual cost can not be known until the order is completed. It may be estimated that a profit will ultimately be made, yet unforeseen conditions, such as strikes, delays in receiving material, etc., may arise to increase the estimated cost. It is better not to include the profits on partial shipments, but information of this character which may have its influence in the decision of the banker upon a proposed loan may properly be laid before him, in the comments which accompany the report. Of course, an exception should be made where the profit on the partial shipments largely exceeds the selling price of the balance of the order.

(20) The selling prices for contract work in progress should be ascertained from the contracts, and where it is apparent that there will be a loss on the completed contract a due proportion of the estimated loss should be charged to the period under audit by setting up a reserve for losses on contracts in progress.

(21) If a company has discontinued the manufacture of any of its products the particular items should be carefully scrutinized and, if unsalable, an amount should be written off to cover all but the scrap value of the articles.

(22) The inventory should be scrutinized to see that no

machinery or other material that has been charged to plant or property account is included therein.

(23) Partial deliveries received on account of purchase contracts for material, etc., should be verified by certificates from the contractors, both as to quantities and prices.

(24) Advance payments on account of purchase contracts for future deliveries should never appear in an inventory, but should be shown on the balance sheet under a separate heading.

(25) Trade discounts should be deducted from inventory prices, but it is not customary to deduct cash discounts. However, this may be done when it is the trade practice to do so.

(26) While the inventory is being verified, the auditor should ascertain the aggregate sales for the last year. A slow turnover may have been due to a poor stock of goods. Some business men dislike to sell below cost, and would rather accumulate a big stock of old goods than dispose of the old and unseasonable stock at a sacrifice. The usual outcome is that the stock becomes unwieldy and funds are lacking to purchase new goods. The inventory and the gross sales may have a direct connection.

SECURITIES. Under this caption should be listed securities in which surplus funds of the company or firm have been temporarily invested and which are considered available as "quick assets," i.e., can be readily turned into money in event of need. When stocks or bonds represent control or a material interest in other enterprises, the ownership of which carries more or less value to the holder aside from the return thereon, they should be considered as fixed assets.

A list of investments should be prepared showing:

Dates of purchases
Description of the investments
Par value of the investments
Denomination of the shares
Number of shares or bonds owned
Total capital stock of the various companies
Amounts paid for the investments
Interest and dividends received
Market values of the investments
The surplus or deficit shown by the statements of condition of the companies, where no market quotations are available.
If hypothecated, with whom and for what purpose.

This list must be compared with the ledger accounts concerned and the total of amounts paid according to the list must agree with the balance of the investment accounts.

The securities must be examined by the auditor in person or he must secure confirmation of their existence from those who hold them as collateral. Those in the company's possession must be counted and examined as soon after the audit starts as possible, and all of them must be submitted at one time. It is much more satisfactory to see the actual securities than to verify cash receipts and other evidence after the audit has progressed.

Certificates out for transfer must be verified by correspondence.

Where the market values of securities are less than the values at which they are carried on the books, save where the variation is so small as to be trifling, a reserve for loss in value on the date of the statement of condition must be set up.

The auditor should determine and comment upon the basis on which the book value is shown; whether it represents cost or par, and if the returns from the investment warrant the value at which it is carried on the books.

Care must be taken to see that the certificates are made out in favor of the company, or that they are indorsed or accompanied by powers of attorney when they are in the names of individuals.

Coupons on bonds must be examined to see that they are intact subsequent to the latest interest payment date.

The investment schedule must show that the interest and dividends receivable by the company have been duly accounted for. The income from the investments shown in the statement of operations account must be in accord with this schedule.

When market quotations for investments can not be obtained, the statements of condition of the companies in which investments are held must be examined so that the auditor may form an idea of their value.

In verifying purchases of stock exchange securities the brokers' opinions must always be examined in connection with the verification of the purchase price.

Investments in deeds and mortgages must be supported by an examination of both the mortgages and insurance policies, and furthermore, it must be shown that all assessed taxes on the property have been duly paid, that the mortgages have been

properly recorded, and that the insurance policies are correctly made out to the company.

If any of the securities have been hypothecated, the fact and amount (book value) must be stated under liabilities in the statement of condition.

CHAPTER IV.

FIXED AND OTHER ASSETS

GOODWILL. Where the item of goodwill is encountered in an examination, show the amount on the statement of condition under a separate caption directly below plant and property, and comment as to how it was created.

PLANT AND EQUIPMENT. The accounts under these captions should present the value of the permanent investment in real estate, property rights, buildings, machinery, tools, etc. The value shown should be either actual cost or a properly appraised value.

Where capital stock is issued for what is commonly called "water," be sure to comment upon it when found in any of the accounts under this caption.

Where credits have been applied to ledger values for any property sold, see that such credit agrees with the original charge or its proper proportion. Where reserves for depreciation are carried, the loss on the sale of a plant and equipment item should be determined as follows: First, the original cost of the item must be credited to the asset account, while the amount of depreciation charged on the item under consideration should be debited to the depreciation reserve. The difference between the cost of the item less depreciation, and the selling price, is an amount chargeable to the profit and loss account. Of course, if the item is sold at a profit, the profit is a credit to profit and loss account. Profits of this kind are rare, however.

The book value of property rights, such as coal veins, where only the coal to be mined is owned, and timber tracts, where the ownership is in standing timber only, should be reduced in proportion to the output from the property. This should be based on an engineering appraisal.

In preparing the leading schedules for the accounts grouped under this heading, such as real estate, buildings, plant, machinery, etc., the balances at the beginning of the period, the ad-

ditions to or deductions from the accounts during the year, and the balances at the end of the period must be shown.

The total of the balances of the period must agree with the cost of property figures given in the balance sheet at that date, and the balances at the end of the period with the amount shown in the balance sheet that is being audited. The charges entering into the additions must be verified in detail, and in this connection the following notes are of value.

(1) Authorizations for the expenditure made during the year should be examined, and where the costs of the additions have overrun the sums authorized, inquiries should be made about them. The authorizations should show the accounts to which the expenditures are chargeable, the amounts thereof, the approvals of the comptroller and manager, and descriptions of the jobs. When the authorizations are not specific as to the work done, the actual additions should, if possible, be inspected.

(2) The auditor should satisfy himself before approving additions that they were made with the object of increasing the earning capacity of the plant, and that they are not of the nature of either renewals or improvements, and in this connection changes in the production and capacity of the plant should receive consideration.

(3) To verify the pay roll and store and supply charges to jobs, one or two pay roll distribution reports should be examined in detail, and also one or two storehouse reports. If large purchases have been made from outside parties for capital construction work, the vouchers therefore should be examined and the usual precautions taken to see that they are properly approved for the receipt of materials, prices, etc.

(4) For purchases of real estate the title deeds should be examined, together with the vouchers, and it should be seen that the deeds have been properly recorded.

(5) While it may be considered permissible to make a charge for factory overhead to additions to property such as time of superintendent and his clerical force employed on construction work, etc., it can not be deemed conservative business practise, inasmuch as the probabilities are that the overhead charges of a plant will not be decreased to any extent even though additions are not under way, and, therefore, the absorption of part of these charges when additions are in progress, has the effect of reducing the operating costs, as compared with months in which no construction work is under way.

(6) Construction work in progress at the end of the fiscal period should be shown in the statement of condition under the heading of fixed assets and not as part of inventories. This is important to bear in mind because construction work is not an asset that can be quickly turned into money, while everything in the inventory is supposed to be capable of ready conversion into cash.

(7) The auditor should determine whether any installments are due on account of construction work in progress which is being carried on by outsiders. If so, the liabilities for these installments should be included in the statement of condition, as they may have a direct bearing on the amount of available cash on hand.

(8) When a company uses leasehold properties the leases should be examined and notes made of the periods covered, so that it may be seen that improvements, etc., on such properties are written off over the periods covered by the leases.

(9) The auditor should satisfy himself that the reserves for depreciation of buildings, machinery, equipment, etc., are adequate to reflect the deterioration in the value of the fixed properties. If in his opinion the reserves shown on the balance sheet are insufficient, he should call attention to the matter in the comments that are a part of the report.

(10) Make sure that property destroyed by fire or otherwise prematurely put out of service is correctly treated in the books. Any portion of the original charge for such property which is not recoverable through insurance, salvage or otherwise, and has not been provided for by the depreciation scheme, should be written off.

It is to be observed that the foregoing notes are to be applied only to cost of properties incurred during the period under audit. In addition, information may well be obtained on broader lines in regard to the composition of the real estate, building, and machinery accounts; to show what principal property is represented thereby; and how the accounts have been built up from year to year for a reasonable time past if not from the inception of the business. The information thus derived is valuable only in indicating the progressive policy of the concern, the extent to which it reinvests undivided surplus in its plant, etc. Beyond these facts the banker who is asked for ordinary discounts or short-term loans is not interested; he looks more to the quick assets for his security.

When a loan is asked which is greater than the quick assets seem to justify, the auditor should suggest that a reliable verification be made as to the cost of the property prior to the period under audit. Such action may become necessary even to the extent of calling for an appraisal by disinteresed outside experts.

RESERVE FOR DEPRECIATION. A reserve for depreciation is a division of surplus set aside to provide for the impairment in the value of an asset due to physical wear and tear, and obsolescence. Where it can be avoided, reserves should never be credited direct to the capital accounts, for the reason that in doing this an estimated amount is credited to an account which should reflect nothing but known values.

Where conditions warrant reserves for depreciation which have not been provided, reasons should be given and the examiner's judgment should be stated. It should be borne in mind, however, that the rates of depreciation are really more of an engineering proposition than an accounting one.

ORGANIZATION OR DEVELOPMENT. The extraordinary costs of starting a new business or developing an old one may reasonably be distributed over a period of years, determined by the condition of the business, or a pro rata amount of such expenses charged annually to operations. In the meantime, the undistributed portion should be shown on the balance sheet as a deferred charge to operation.

The Internal Revenue Department has arbitrarily ruled that the extraordinary cost of starting a new business or developing an old one cannot be charged off either at one time or over a period of years as a deduction from income. As a result thereof, such cost should be segregated into an account classified as "organization expense," which should be treated as an asset and should be considered as such in the computation of invested capital for tax purposes. Its place on the statement of condition should be immediately after the setting up of the so-called "fixed charges" section. For the company's own convenience, from the point of conservatism, this account can be written off, as there is nothing to prevent such operation, but it must be borne in mind that whatever is written off is not an allowable deduction, in computing net income subject to the Federal Income Tax.

DEFERRED CHARGES TO OPERATIONS. Under this heading in the statement of condition are grouped such items as unexpired insurance, discounts applicable to a future period, prepaid royalties, experimental charges, etc. After the clerical accuracy of the deferred charges has been verified the auditor should satisfy himself that they are properly carried forward to future operations.

Whenever possible, documentary proof must be produced in support of the items carried forward. For example, with unexpired insurance the policies must be examined to verify the dates of expiration, the amounts covered, and the proportion of the premiums carried forward; with royalties the agreements must be examined; with experimental charges the vouchers and particulars of the work done must be looked into.

Many concerns inventory stationery, advertising matter, and other items of a miscellaneous nature at the end of the fiscal periods. Do not treat such items under the general head of inventory, but present them under prepaid operating expenses.

Postage of a current nature, and items such as advances to salesmen for salaries or expenses, which will eventually be taken up in the operation, should be shown on the statement of condition as prepaid operating expenses.

Bills for merchandise paid in advance of receipt of goods should be presented under current assets.

Large advances to subsidiary concerns or to individuals in anticipation of the division of profits or dividends, should be carefully investigated to ascertain their exact nature. It is often well to present advances of this sort under a separate caption of "advances," which should follow inventory and current assets.

The examination of deferred charges will usually furnish the auditor with valuable information in regard to the accounts of the company. For example:

(1) The verification of experimental charges carried forward may give information as to the production and future policy of the company.

(2) Royalty vouchers will sometimes give a check on the production of mines.

(3) An examination of the insurance policies will show if the properties are mortgaged or covered by lien, and will thus be an additional verification of the liability for mortgages on real estate, buildings, etc., shown in the statement of condition.

(4) The insurance should be checked against the assets and if any of the latter are not covered, the omission should be mentioned.

The auditor will often find included in deferred charges to operations the item of coal inventory. This is not a prepaid expense nor is it a deferred charge to operations. Any inventory such as this should be classified as such, for coal when used in manufacturing is just as important an element of operation as the raw material which is being fabricated.

CHAPTER V.

LIABILITIES AND CAPITAL

NOTES AND BILLS PAYABLE. Under this caption also appear loans and drafts accepted. Schedules should be prepared in columns under the sub-captions:

- Date of making the notes or drafts
- Due dates
- Names of creditors
- Collateral hypothecated
- Additional Indorsers
- Interest accrued to date of audit
- Notations of renewals (as information of this nature furnishes a guide to the state of the concern's credit.)

The schedule must be compared with the notes-payable records and the total of the aggregate must agree with the balance of the ledger account of notes payable.

Statements must be obtained from all banks of notes sold by them for the benefit of the concern. These statements, when received, must be checked against the loan shown on the concern's books.

Inasmuch as a note is a negotiable instrument, care must be taken to see that all of those recorded as paid during the year under audit have been properly discharged, and the cancelled notes are the best evidence of this fact.

Careful attention must be given to the collateral deposited for loans, and statements as to the existence of such collateral should be obtained from the holders thereof. Such hypothecations of any of the concern's assets should be accounted for on the statement of condition.

Money borrowed from banks or individuals should be listed as loans payable, and distinct from notes payable, which should include such obligations as are given in settlement of creditors' accounts for merchandise, etc.

When practicable the auditor might suggest to the client the advisability of drawing notes on blanks bound in a book, like a check book, with a stub or carbon copy record of each blank,

the blank and the stub or copy to bear identical numbers. The officer, or officers, signing the notes could, in such case, initial the stub as a certificate to the amounts, payees, and terms of the notes issued. If this were done, the auditing of bills payable would be greatly facilitated.

ACCOUNTS PAYABLE. A list of balances due on open accounts must be prepared and carefully checked with the ledger accounts, care being taken to see that no open account on the ledger has been omitted from the list. It should be ascertained that the balances represent specific and recent items only. When any account does not appear regular a statement from the creditor should be obtained. If there are many such accounts in dispute, and they amount to so large a sum as to affect appreciably the total of current liabilities, the general causes for the disputes should be inquired into and note made of the matter for the consideration of the banker.

In concerns with a modern charge register system, accounts payable are easily verified, as all liabilities are then included in the books when incurred. Care should be taken, however, to see that all goods received on the last day of the fiscal period, as shown by the receiving records, and also all goods that were in transit and belonged to the concern on that date, are included as liabilities, and the corresponding assets included in the inventories. This test is necessary as an increase in the accounts payable may have a very important bearing on the financial position of the concern if the cash on hand is small.

Monthly expenses outstanding can usually be ascertained by a comparison of the expenses of the last month of the fiscal period with previous months, and those of the year with the previous year. The charge register should, however, be examined for the months subsequent to the close of the fiscal year, to find out if any expenses included therein are applicable to the fiscal period under audit.

When a first-class system is not in operation, the auditor must take additional precautions to satisfy himself that all liabilities are included in the accounts, among which may be mentioned:

(1) Payments made in the months subsequent to the date of the fiscal period as shown by the cashbook, which should be carefully scrutinized to see that none of them are applicable to the period under review.

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

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Dear Sir:

We are engaged upon an audit of the books and accounts of..
and it appears that on...........................19....
there was due to you a balance of $............

Will you please advise upon the attached blank if the amount is correct, as of the date shown, irrespective of subsequent payments or increases of indebtedness? If it is not please send a detailed statement to enable us to rectify the error.

The work we are engaged upon is in behalf of the company being audited and is designed for the verification of the condition of the books only.

Your compliance with our request will be appreciated,

Very truly yours,
JOHN BLANK & COMPANY, Inc.
By........................

......................19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

The correct balance due us by the....................
....
upon............................19.... was $..........
....

(2) The file of bills not vouchered or entered on the books should be examined to see that none of them belong to the period under audit.

(3) A careful perusal of the minutes of a company may further assist the auditor in determining liabilities.

When a company has large purchase contracts in force for future delivery they should be examined, for if the contract prices are greater than market prices, it might be necessary to set up a reserve for this loss. Any debit balance, due to advance payments to any other cause, should be down on the statement of condition, under separate heading.

If the business under audit is one in which there is any possibility of goods having been received on consignment, and part or all of such goods having been sold without a liability therefore having been shown in the books, the auditor must be sure to cover the point fully. This may readily happen, as consignment accounts are usually treated as memoranda only.

If inquiry shows that goods have been received on consignment, all pertinent records shoud be called for. If the goods have all been sold, the consignor's account should show the full amount due, and if the debt is a current one, the amount will appear among accounts payable due to trade creditors. Where only part of the goods have been sold, the net proceeds due to the consignors should be shown on the statement of condition under the caption of "accounts payable to consignors."

As an additional precaution against the omission of liabilities, a statement should be obtained from the proper officer or member of the concern stating that all outstanding liabilities for purchases and expenses have been included in the accounts of the period under review, or of former periods. In many cases it is also advisable to obtain a certificate from the president stating that all liabilities for legal claims, infringements of patents, claims for damages, bank loans, etc., have been included, as he may be the only executive officer of the company to know the extent of such obligations.

Every effort should be made to see that all liabilities are entered in the book, during the month that such liability is incurred, and that all liabilities are reflected upon the records as of the date of closing of the period under review. Especially is this necessary where we are called upon to make monthly audits and present monthly statements of condition and operating statements.

CONTINGENT LIABILITIES. It is not enough for a statement of condition to show what must be paid; it should set forth with as much particularity as possible what may have to be paid. The auditor who makes a statement of condition audit, must discover and report upon liabilities of every description, not only liquidated and actual debts, but possible debts. The following are the usual forms under which contingent liabilities will be found:

Inquiry of the officers or partners of the concern should be made as to whether any indorsement of outside paper has been made and as to any security received to protect the concern. Such inquiry should be particularly strict if it is known that any of the officers or partners are interested in other enterprises.

Similar action should be taken in the matter of guaranties.

Contracts for delivery of goods contracted for before the date of the statement of condition, may call for the payment of large sums of money within a short time. In the case of raw materials, for a manufacturer, this might be a perfectly legitimate reason for seeking a temporary loan, pending production and sale, but for a merchant whose statement of condition shows a large stock of goods on hand, it might indicate a real liability impending, with assets of a doubtful character to offset it. In every audit, therefore, the auditor should call for copies of all orders for future delivery, and if such orders call for stock in excess of the current and reasonable prospective demand, mention should be made on the statement of condition and a report submitted, the details depending upon the circumstances.

Items other than those arising from the specific hypothecation of current assets to be listed as liabilities should appear as a footnote on the liability side of the statement of condition, the total amounts being stated for each subheading and such additional report made as will convey clear information to the banker.

Wherever it is possible to ascertain the amount of a contingent liability, a note should be placed at the bottom of the statement of condition somewhat as follows:

"Subject to a contingent liability of $.......... for indorsement or discounted notes receivable, claims, damages at law including incomplete contracts, guaranties and agreements."

Where an exact figure cannot be assigned the contingent liability, the auditor should make a comprehensive comment to

that effect. Otherwise, add the sum involved to the comment or footnote as shown in the preceding paragraph.

ACCRUED LIABILITIES. Under this caption are grouped such items as interest, taxes, wages, etc., which have accrued to the end of the period under audit, but are not due and payable until a later date. The verification of such items can be accurately made from the books and records. Special attention should be given the following points:

Many of the liabilities which appear on a statement of condition carry interest. Such items as bonds and notes payable obviously do, but the auditor should also consider the possibility of accounts also bearing interest, as enough book accounts, when past due, do bear interest to warrant inquiry being made. Loan accounts of partners and officers of corporations almost invariably bear interest; also judgments, overdue taxes, and other liens.

The amount of accrued State and local taxes can be ascertained from an examination of the latest tax receipts; although sometimes, as the period for which the taxes are paid is not shown on the receipt, it may be necessary to inquire of the proper taxing authorities as to the period covered.

Under the Federal Income Tax Law, a tax is imposed upon the net profits of a corporation, which must be paid even if the corporation is dissolved before the end of the year during which the tax is imposed. As the tax is specifically based upon the net profits of a particular period, although payable some months thereafter, the tax accrues throughout the specified period, and if a net profit is disclosed upon the closing of the books, a reserve must be shown on the statement of condition as an accrued tax. An exception was made in 1918 and 1919, for Congress was so tardy in its determination of the rates of taxation that many audits were completed before the tax rate was set and the regulations issued by the Treasury Department. In normal years, however, no statement of condition should be issued without a reserve for Federal Income and Excess Profit Taxes being established, for the sum involved is seldom inconsequential.

When the date of the statement of condition does not coincide with the date to which the last payroll of the period under audit has been calculated, the amount accrued to the date of the statement of condition must be ascertained and entered as a

liability, unless such amount is trifling. It will suffice to take the proper number of sixths of a full week's pay roll (six days) without reference to possible daily variations.

In a large business, where an accumulation of unclaimed wages is in the custody of the cashier, the amount stated to be on hand should be examined to prevent its being diverted temporarily to cover shortage in the petty cash fund. Where unclaimed wages reach a considerable amount, they should be re-deposited and credited periodically to a ledger account entitled "unclaimed wages."

Where bills for such expenses as water, gas, etc., are not rendered monthly, the auditor must enter the accrual of the proper proportion since the last bill as a liability.

It is important to note whether the accounts of all traveling salesmen have been received and entered before the books are closed. The auditor should secure a list, and if any report was not so entered, provision should be made for it unless the amount is likely to be trifling.

Ample provision should be made for all commissions eventually payable on sales which have been billed to customers. As commissions are frequently not payable to salesmen until the accounts have been collected from the customers, accrued commissions are often omitted from the books. As they must, however, be paid out of the proceeds of the sales of which the full profit has already been taken into the accounts, they should be set up on the statement of condition as an accrued liability.

All concerns have more or less litigation. Before the books are closed the lawyers should be requested to send in a bill to date. If one is not found, the auditor should ascertain the amount probably due and set it up as an accrued liability.

If the concern is insured against liability for damages to employees or the public, a proportion of the premiums paid in advance for the unexpired time covered by the insurance will appear in "deferred charges." But there may be claims or suits for other damages not covered by insurance, and where the auditor finds any evidence which leads him to suspect there may be liability of this nature he should insist upon being informed of all the facts. He can then form an accurate opinion as to the amount that should be set up as an accrued liability, or, if the outcome is uncertain, as a reserve against possible loss.

BONDED AND MORTGAGE DEBT. A copy of the mortgages must be examined and the terms thereof noted. The amount of bonds authorized, issued, and in treasury, rate of interest, and duration of the bonds, should be shown on the statement of condition. A certificate should be obtained from the trust company, certifying the amount of bonds authorized, outstanding, unissued and retired, as verification of the liability shown in the statement of condition. The interest on the bonds, as shown in the statement of condition should be calculated and reconciled with the interest on bonds, as shown in the statement of operations. Bonds unissued are in no sense treasury holdings. To be such, they must have been certified and delivered by the trustee.

Sinking-fund provisions in mortgages should be carefully noted and care should be taken to see that they are provided for in the accounts of the company, and any default noted in the statement of condition.

Bonds redeemed during the period or previously should be examined to see that they have been properly canceled, or, if they have been destroyed, a cremation certificate should be obtained from the trustees.

Funds or securities on deposit with a trustee or agent for this purpose, should be verified by a certificate received direct from the depository.

Where this fund is applied periodically to the cancellation of bonds thereby actually reducing the bonded debt, instead of cash or bonds being carried in the sinking fund, show the amount of bonds so retired as a reduction from the bonds issued on the liability side of the statement of operations and verify the retirement of such bonds by a certificate from the trustee.

Mortgages sometimes stipulate that the current assets must be maintained at a certain amount in excess of the current liabilities, and the auditor must give due consideration to such matters and any other stipulation in regard to the accounts, or any audit thereof, that may be referred to in the trust deed, and see that they have been complied with.

As a mortgage derives its chief value from the fact that upon registry it becomes a lien, the auditor should verify the existence of such an obligation by inspecting the public records, not only with reference to such as may be found on the company's books, but also any that may still appear on the public records

as unsatisfied. If the auditor lacks the necessary facilities for making a search it will be worth his while to arrange with a local lawyer or title company to report to him any mortgages or judgments entered against the concern.

In any event the auditor must verify the amount as recorded in the account, the rate, the due date, and the property covered thereby.

It should be borne in mind that a payment on account of a mortgage must be recorded or the entire amount will remain as an encumbrance on the property. Therefore, if payments on account appear, the auditor should ascertain if they have been so recorded; if not, the fact should be noted on the statement of condition.

The same procedure should be followed in verifying judgments as in verifying mortgages. As many business men consider that the entry of an invoice is an admission of liability, and will not permit the entry of a claim which they propose to fight, it is sometimes difficult for an auditor to find any evidence of such liens. Even admitting the fact, they may still refuse to allow the judgment to be entered on the books as a liability. In this event it is proper for the auditor to include it as a footnote to the statement of condition as a contingent liability.

When considering liens it should be noted that interest unpaid is a lien as well as unpaid principal, so where the auditor finds evidence of interest on liens being in default, he should add it to the principal in each case.

CAPITAL STOCK. The amount of authorized issue should be verified by an inspection of the certificate of incorporation, and if additions to the original amount have been made, by an inspection of the authority from the stockholders and directors, as reflected in the minute book as well as authority from the State for the increase. Stock authorized and unissued should be shown as "unissued," and not as "treasury holdings." If cancelled certificates are not properly recorded, list exceptions.

As a rule, trust companies are the transfer agents for the capital stock of large corporations, and for verification purposes it is sufficient to obtain letters from them, certifying to the capital stock outstanding.

With companies which issue their own stock, the stock registers and stock certificate books should be examined and compared with the lists of outstanding stockholders.

In the statement of condition each class of stock must be stated, giving amount authorized, issued, and in treasury. If the company has cumulative preferred stock outstanding, a note must be made in the statement of condition of the dividends accrued, but not yet declared.

If stock has been sold on the installment plan, the auditor should ascertain that the calls have been properly extended to the stockholder. Approval of the board of directors is necessary and the minutes should be examined accordingly.

If any stock has been sold during the period under audit, the auditor should verify the proceeds of the sales.

TREASURY STOCK AND BONDS. Capital stock becomes treasury holdings, after it has been issued for value received and has been returned to the company as is true when capital stock is donated for working capital or purchased by the company.

Bonds become treasury holdings after they have been certified by the trustees and delivered.

Securities in treasury should be shown at not less than par.

Securities held in treasury should be verified by an inspection of the securities themselves, or by proper receipts, or by certification, if in other than the owners' hands. Care should be used at all times to see that receipts are genuine. In bank examinations, always secure independent certificates and have them mailed direct to the office. This is not always practicable in commercial work, but independent certificates should be secured in all possible cases where the receipts on file do not contain a commercial seal of the holding parties, as in the case of insurance and banking departments.

SURPLUS. The auditor should consider the surplus at the beginning of the period. This item represents the accumulated profits prior to the beginning of the fiscal period under review, and should be compared with the surplus shown on the statement of condition of the previous year, and with the ledger account, to see that it corresponds. If it does not, a reconciliation statement should be prepared, giving full details of the differences.

CHAPTER VI.

STATEMENT OF OPERATIONS

PROFIT AND LOSS. The auditor should obtain the statements of operations for three years at least, including the period under audit, and after verifying them by comparison with the ledger account, prepare a statement in comparative form. This comparison will furnish valuable information to the banker as to the past progress of the concern under audit.

A satisfactory form of statement of operations is shown on page 56.

While it would be impracticable and somewhat useless in an ordinary statement of condition audit, to make a detailed check of all the transactions entering into the composition of the statement of operations account, there are certain main principles to be kept in view which are briefly outlined in the following pages.

SALES. Whenever possible, the quantities sold should be reconciled with the inventory on hand, at the beginning of the period, plus the production, or purchases, during the period, less the inventory on hand at the end of the period. Where a proper cost system exists, the inventories at the beginning and end of the periods comprise only "goods in process" and "finished stock," and the operating statement, should be so worded. Additions then, instead of being "purchases" are of materials consumed in the manufacture of more goods.

Where a good cost and accounting system is in force, the sales records will probably be in good shape, but nevertheless, the auditor should satisfy himself from the shipping records that the sales books were closed on the last day of the fiscal year, and that no goods shipped after that date are included in the transactions.

When an audit is being made for the first time, the auditor should satisfy himself that the sales at the beginning of the period were recorded in accordance with the dates of shipments. Such verifications can be made conveniently, by a direct comparison of the shipping memoranda with the invoices billed.

Allowances to customers for trade discounts, outward freights, reductions in prices, etc., should be deducted from the sales in the statement of operations, as the amount of net sales is the only figure of interest to the bankers.

The future bookings at the close of the fiscal year should be looked into, as a comparison of orders on hand with corresponding periods of other years furnished the bankers with an idea of the concern's business outlook.

FREIGHT. Freight prepaid on shipments to customers and deductions made by customers for freight paid by them (where the shipments have been delivered), are a deduction from the gross sales and should be treated separately from freight paid on incoming material. The former reduces the amount of the sales, while the latter increases the amount of the inventory purchases.

COST OF SALES. The inventory at the beginning of the period, plus purchases during the period, less inventory at the end of period, gives the cost of sales. In a manufacturing concern the factory cost of production takes the place of purchases. As has already been stated, if a good cost system exists, the form of operating report will differ vastly, for it is then possible to show, not only goods purchased but also consumption. The preferred form for that part of an operating statement is briefly:

(Standard Heading)

(Details as to sales, deductions, etc.)
COST OF GOODS SOLD:
Inventory at beginning of period:

Goods in process.....................					$.......
Finished goods on hand.....................					$.......
Materials:	On hand beginning of period	Purchased during period	On hand end of period	Consumed	
(List of principal materials).....	$.......	$.......	$.......	$.......	
....	$.......	$.......	$.......	$.......	
....	$	$.......	$.......	$.......	
....	$.......	$.......	$.......	$.......	
Total materials consumed.....................					$.......
Total materials consumed.....................					$.......
Productive labor, etc., etc.....................					$.......

Most of the items under "cost of sales" will have been verified in auditing the statement of condition, but nevertheless, care

should be taken to see that this heading has not been made a dumping ground for charges which would be more properly embraced under the heading of special charges. The composition of the items entering into the cost of sales should be traced into the cost records or accounts.

GROSS PROFIT ON SALES. This is obtained by deducting the cost of sales from the net sales. The ratio of gross profits to net sales should be calculated and compared.

SELLING, ADMINISTRATIVE AND GENERAL EXPENSE. Under these general headings should be set down the expenses, itemized to correspond with the titles of the ledger accounts kept in each division. In checking the totals of each account with the statement for the period under audit, special attention to credits in these accounts should be given to see that none have been made for the sale of capital assets and for items which should not appear in expense accounts. The percentages of the totals of each division and of the aggregate total to net sales should be calculated for each year for comparison.

Where a good cost system exists, only two general divisions of overhead expense will be found; that is "factory" and "selling."

General expenses, after all, exist for some purpose and should be distributed to the factory or the sales department—whichever is served. This, however, can be done only when a system showing fundamental influences upon expenses, is in operation.

Administrative expense, similarly, is distributable upon analysis, for the administrative officials direct either the factory or sales policies.

Financial executives are a distributable cost, for they are needed by both of the principal divisions.

When, however, a reliable cost system does not exist, set up separate headings for "factory expense," "selling expense" and "general and administrative expense."

NET PROFIT ON SALES. This is obtained by deducting the aggregate total of the selling, administrative and general expenses from the gross profit on sales, and shows the net earnings of the concern on its principal business. The ratio of net profit to sales should be calculated for each year in order to give comparative figures.

OTHER INCOME. Under this heading is embraced any income that may be derived from sources outside of sales, such as income from investments, interests, discounts, etc. Schedules should be prepared of each item, and the auditor should satisfy himself of their accuracy and of the propriety of including them as income.

DEDUCTIONS FROM INCOME. Under this heading are grouped such items as interest on bonded debt, interest on notes payable, etc. The same procedure of verification as for "other income" should be followed.

NET INCOME—PROFIT OR LOSS. Adding "other income" to "gross income" and deducting "deductions from income," gives the "net income" or "profit or loss" for the period, which is the amount that should be carried to the surplus account.

SURPLUS—ADDITIONS AND DEDUCTIONS. Items of unusual or extraordinary profit which do not belong strictly to the period under audit, or can not be said to be the legitimate results of the ordinary transactions of the concern, should be entered here and verified with the surplus account. Deductions should be similarly treated. Also, dividends declared should be entered in the surplus account and as an item under this caption, inasmuch as it is the usual custom to declare dividends from net earnings and surplus. After adding special credits to and deducting special charges from the net income we have the total profit or loss for the whole period from all sources, which, added to the surplus balance at the beginning of the period, gives us the surplus at the end of the period, which should agree with the surplus as stated on the statement of condition.

The miscellaneous information in the next chapter is added without preserving the order of the items on the statement of condition, for in some cases the suggestion applies to several statement of condition headings.

CHAPTER VII.

GENERAL INSTRUCTIONS

SALES AND PURCHASE LEDGER BALANCES. These balances, in a statement of condition, should show the gross amount of both the debit and credit columns, instead of the net amount. In other words, the aggregate balance due from customers, whether or not shown by general ledger controlling accounts, should not be shown under accounts receivable as net. Credit balances should be included in the current liabilities, and classified as "credit balances on accounts receivable." The aggregate balances of creditors' ledgers should likewise be shown separately, the debit balances being included in the current assets and classified as "debit balances on accounts payable." Whenever possible, we should correspond to verify correctness of items shown due to or due from creditors and debtors. When this is not permitted the lack of such verification should be commented upon.

AGREEMENT FOR THE SHARING OF PROFITS. Agreement between managers, superintendents, or other employees of concerns, as to extra compensation in the form of a percentage on the gross sales on net earnings of a business, should be examined (in the case of a corporation, such agreement to be effective should usually be recorded in the minute book) to define the proper method of arriving at such division of profits. An immediate factor in defining the cost of operation under such arrangement is the interest on the capital, which should be added to the ordinary expense.

EMPLOYEES' FIDELITY AND BENEFIT FUNDS. Amounts deposited by employees, fidelity funds and amounts deducted from wages to maintain sick and accident benefit funds should be presented as a liability under the caption of "trust funds."

INTEREST CHARGES BETWEEN PARTNERS. If an interest agreement exists in a partnership providing for unequal capital

invested, and the interest in the business is share and share alike, the interest chargeable against the partner having the smaller amount of capital can be for one-half of the actual difference in capital.

PARTNERSHIP AGREEMENTS. Partnership agreements should be examined to verify the basis of arriving at the proper division of profits. The capital accounts of partners should be analyzed for the full knowledge that the respective accounts show only the investment contributed as such, and not other items, such as money borrowed from the outside, upon which the interest is paid by the firm. Such items should be deducted from capital accounts and shown as "loans payable."

Operating charges should not be entered in partners' drawing accounts, or applied as a reduction of their capital accounts. It will be seen that should partners desire to show inflated profits for any period, for the purpose of disposing of the business advantageously to themselves, they could, by charging costs of conducting the business to their capital accounts, make an excessive showing of the profits of the business.

ANTICIPATED PROFITS. Charges against customers, which are treated as accounts receivable can only be for goods delivered or services performed; in fact, earned income. Charges should not be made for unexecuted contracts or orders as shown on hand, unless the cost of the unexecuted contract or order is shown at its full present and prospective liability.

As already stated, inventories should always be presented at a live inventory cost price. Should an inventory be taken at a selling price, it would have the effect of anticipating profit.

INSURANCE. If such materials as tobacco, sugar, hemp, chemicals, etc. are used, where yearly policies of insurance are written on merchandise in warehouse, which is subject to consumption, an examination of all cancelled policies should be made to verify the proper returns on cancellation.

SURETY COMPANY CASES. When we are notified of a loss, the first thing to do is to visit the surety company requiring our services and obtain a copy of the policy, with all riders attached, and any further information in regard to the insured, the loss, or the detective's report. The claimant should then be visited

immediately, all of his books stamped or initialed and numbered and a list taken of them. Notes should be taken regarding any inventories which he has; detail regarding the company—its business, volume, names of partners, managers and bookkeepers.

Any wrappers, boxes or visible evidence of loss should be marked and a list taken of them, and the claimant should be told not to destroy these until the claim has been settled.

In fact, get all the preliminary data and notes having a bearing on the work, but do not do any of the work until the claimant has submitted his proof of loss. It is well to have him state the approximate amount believed lost.

GENERAL. These instructions cover audits of small or medium sized concerns. In large concerns having, for instance, tens of thousands of accounts or notes receivable, the detail procedure suggested would be impracticable, and internal checks should make it unnecessary. In such cases only tests can be made, but the auditor must always be prepared to justify his departure from a complete program by showing that the purposes sought to be accomplished thereby have been adequately effected by his work.

Any extensive clerical work, such as the preparation of lists of notes receivable etc., should be performed by the client's staff so as to avoid unnecessary employment of the staff in merely clerical work with consequent undue expense.

In the preceding instructions we have chosen to present the procedure to be followed, so that the utmost in security will result, when the statement of condition is certified. When the work to be done includes the checking of all cash transactions throughout the year to guard against peculations by employees, certain added work must be undertaken.

All correspondence to verify the accuracy of the accounts and notes, both payable and receivable, and of cash in banks etc., serves the dual purpose of, on the one hand, proving the existence of the assets or the extent of the liabilities; and, on the other hand, of proving that money has not been received from accounts still purporting to be due.

To audit cash disbursements thoroughly, in addition to the verification of money remaining in the banks, all checks drawn throughout the year should be scrutinized and checked against the cash book or check register or voucher or charge register. Indorsements should be examined. Whether an indorsement

is genuine, cannot, of course, be determined at a glance; but if the checks show that they have traveled through one or more banks the authenticity of the indorsement is fairly established by the banks' action. This precaution is necessary as supposed checks have been drawn and canceled to hide abstraction of cash.

For the same reason cash records should be added so that false additions may not conceal losses.

All deductions not vouched for by returned paid checks, must be examined.

The drawing of a check does not prove the propriety of a disbursement. A further check against dishonesty is to compare the checks or checked entries of disbursements, with the original invoices and bills. Where such evidences of purchase do not exist, careful research should be conducted.

There have been cases of more than one check drawn to pay the same invoice, the later check being diverted. Petty officers have often purchased personal articles through company charge accounts; and particularly where the owners are not active, executives have been known to operate automobiles, renovate homes, etc., at the company's expense on the assumption that payment by direct checks would not be detected. The auditor must, therefore, decide after studying a bill, if the purchase is in the company's interest.

Obviously, in a profession in which countless books have been written we cannot attempt to cover exhaustively all the ramifications of audits conducted under all circumstances, for the auditor must guard against every fashion of loss, ranging from the sale of unchecked materials for cash, to the taking of returned insurance premiums.

It is only by the exercise of every intelligence and by constant alertness that reasonable safety can be assured to clients.

In every event, before work is undertaken, the printed program reproduced on page 6 should be studied and amplified to suit the needs of the current situation. Upon the presumed completion of the work, the situation should be reviewed and omissions sought.

In the preceding instructions, we have spoken dogmatically, but the practise as laid down is in accordance with that of the Federal Reserve Bank. It must always, however, be borne in mind that auditors are the clients' employees. At the same time the auditors must be bound by the ethics of the profession,

for they are to a certain extent public characters. Nevertheless, an auditor cannot prosper if he affronts clients, and even when sent to make an examination of a third party's affairs, can suffer by over-insistence.

Though we have told what constitutes an examination, examination can be carried only as far as the client will permit. A client's decision not to permit correspondence with his debtors to verify his accounts receivable, may not mean that the accounts are of questionable value. The client may believe the expense of the effort to be unjustified; may not want to risk misinterpretation by stirring up his customers, may have other good reasons for limiting the work. These limitations must be accepted gracefully, and without suspicion, if they originate with the proper authorities of the client's company.

In the comments attached to the report, however, heed must be given to the public character of the work, by stating the extent to which it has been carried.

This will serve a warning to bankers and others, reading the statement, so that, if they are not satisfied with the extent to which the examination has been carried they can urge or instruct the client to permit further investigations.

The following pages contain samples of the forms used in corresponding with an audit client's debtors or creditors or with his banks.

REPORTS. Junior accountants are ordinarily readily obtainable; it is when he becomes a senior accountant, able to prepare any sort of report beyond criticism, that a man becomes of real value to himself or his employers. Such auditors are in demand.

Ordinary business documents, such as letters, telegrams, etc., are given passing scrutiny and are then generally lost in the files. Auditors' reports travel from hand to hand, and are subjected to minute scrutiny by many competent men. Aside from the clients' executives who are usually better acquainted with the affairs described than the auditors, the reports are analysed by bankers, note-brokers and Internal Revenue collectors, many of whom are your equals in accounting practise.

Reports must therefore, be not only arithmetically correct, but care must be taken to provide proper and informing titles of account, to group related figures, and to check all

references and accounts, so that they will tell a consistent story. Undesirable exceptions to this policy repeatedly are observed. One report the writer recalls gave different inventory figures, for the same date, in the statement of condition and statement of operations. The accountant's verbal explanation was that the statement of condition total was the aggregate of all inventories, while the operating statement carried a part in the closing of the section entitled "cost of goods sold," where the inventory at the end of the period was deducted, the balance having being deducted from various figures before they were used, such as coal, to provide a "coal consumed" figure, etc. Though explainable, such a report is not accurate or logical save where titles and differing figures are so shown that the connection can be traced.

Similarly subject to suspicion by an outside reader was another report giving depreciation deducted on the operating statement as approximately $110,000 but speaking in the comments of depreciation taken as $112,000. The difference was found to be branch office furniture depreciated and charged into selling expense. The charge is properly a selling cost but the report was given the appearance of error, by conflicting and unexplained figures.

The principal exhibits and the introductory letters have been so standardized by universal custom as to make their use in a given fashion almost mandatory. The following should therefore not be deviated from except for very good reasons.

FORM OF CERTIFICATE. The statement of condition and certificate should be connected with the accounts in such a way as to ensure that they will be used only conjointly. This rule applies also to any report or memorandum containing any reservations as to the auditor's responsibility, any qualification as to the accounts, or any reference to facts materially affecting the financial position of the concern.

The custom is to place conspicuously on each statement of condition and operating statement the sentence, "this statement is subject to our comments upon the examination" (if many comments that cannot well be contained in an introductory letter, are appended); or "This statement is subject to the comment contained in our introductory letter."

Introductory letter, comments and statements are then bound in one cover, and the absence of any one when

the report is examined will arouse the reader's suspicion.

The certificate when issued is invariably appended to the foot of the introductory letter. The formal certificate, however is added only when requested.

A complete introductory letter with a somewhat different certificate, if a form be preferred, is given below.

The certificate should be as short and concise as possible, consistent with a correct statement of the facts; and if qualifications are necessary state them clearly and concisely.

If the audit has been complete and conforms to the general outline given hereinbefore, and the statements of condition and of operations are correct and all minor qualifications are fully covered by the foot-notes on the statement of condition, the following form is proper:

> We have audited the accounts of .... for the period from............................to........................
> and certify that the attached statement of condition and statement of operations in our opinion set forth the financial condition of the company at............................and the results of its operations for the period under review.

INTRODUCTORY SHEET FOR THE USUAL COMMERCIAL EXAMINATION

Dear Sirs:

In accordance with your request, we have made an examination of the books and accounts of................................
for the period from.....................to................
(or for the year ended......................).

The results of this examination, together with our comments thereon, are presented in the following exhibits and their related schedules:

EXHIBIT "1."	Statement of Condition as of............
Schedule "A."	Securities Owned.
Schedule "B."	Accounts Receivable.
EXHIBIT "2."	Statement of Operations for the..........

We certify that, subject to our comments, the statement of condition and related statement of operations, presented herewith, are true exhibits of the accounts, and correctly set forth the financial condition of the company as of..................and the operations for the period stated.

Very truly yours,

JOHN BLANK AND COMPANY.

By

C. P. A., M. A. I. A.

EXHIBIT "1"

....COMPANY

STATEMENT OF CONDITION

As of

....................................19......

ASSETS

Current Assets and Inventories:			
Cash:			
Cash on hand—currency and coin		$.......0.00	$
Cash in bank		........0.00	
Total cash			......0.00
Notes and Accounts Receivable:			
Notes receivable of customers on hand (not past due)		........0.00	
Notes receivable, discounted or sold with indorsements or guaranty		........0.00	
Notes receivable, customers, past due (cash value $......)		........0.00	
Accounts receivable, customers, past due (cash value $........)		........0.00	
		........0.00	
		....	
Less:			
Provisions for bad debts	$.......0.00		
Provisions for discounts, freight, allowances, etc	........0.00	........0.00	
Total Notes and Accounts Receivable		....	........0.00
Inventories:			
Raw material on hand		........0.00	
Goods in process		........0.00	
Uncompleted contracts	$.......0.00		
Less payment on account thereof	........0.00	........0.00	
		....	
Finished goods on hand		........0.00	
Total Inventories		....	........0.00
Other Current Assets:			
(Described fully.)			
....		........0.00	
....		........0.00	........0.00
Total Current Assets and Inventories		....	........0.00
Securities Owned:			
Securities readily marketable and salable without impairing the business		........0.00	........0.00
Notes given by the officers, stockholders, or employees		........0.00	........0.00
Treasury Stock			........0.00
Plant Property and Equipment:			
Land used for plant		........00.0	
Buildings used for plant		........0.00	
Machinery		........0.00	
Tools and plant equipment		........0.00	
Patterns and drawings		........0.00	

Plant, Property and Equipment (*Continued*)		
Office furniture and fixtures	0.00	
Other fixed assets, if any (describe fully)	0.00	
	0.00	
Total	0.00	
Less	0.00	
Less:		
Reserves for depreciation	0.00	
Total, Plant, Property and Equipment		0.00
Prepaid Operating Expenses:		
Prepaid expenses, interest, insurance, taxes, etc.	0.00	
Total Prepaid Operating Expenses		0.00
Good-Will		0.00
Total Assets		$ 0.00

LIABILITIES AND CAPITAL

Liabilities:		
Current Liabilities:		
Unsecured Liabilities		
Bills, notes and accounts payable; Unsecured bills and notes; Acceptances made for merchandise or raw material purchased	$ 0.00	$
Notes given to banks for money borrowed	0.00	
Notes sold through brokers	0.00	
Notes given for machinery, additions to plant, etc.	0.00	
Notes due to stockholders, officers, or employees	0.00	
Accounts payable for purchase, (not yet due)	0.00	
Accounts payable for purchase, (past due)	0.00	
Accounts payable to stockholders, officers, or employees	0.00	
Secured Liabilities:		
Notes receivable, discounted or sold with indorsement or guaranty (contra)	0.00	
Customers' accounts discounted or assigned, (contra).	0.00	
Obligations secured by liens on inventories	0.00	
Obligations secured by securities deposited as collateral	.000	
Accrued liabilities (interest, taxes, wages, etc.)	0.00	
Other Current Liabilities:		
(Described fully)		
	0.00	
	0.00	
Total Current Liabilities		0.00
Mortgages:		
Mortgages on plant, (due date)	0.00	
Mortgage on other real estate (due date)	0.00	
Chattel Mortgage on Machinery or Equipment, (due date)	0.00	
Bonded debt, (due date)	0.00	0.00
Other Fixed Liabilities:		
(Described fully)		
	0.00	0.00
Total Liabilities		0.00

Capital:			
Preferred Stock: (Par value $........ per share)			
Authorized shares..................	$.......0.00		
Unissued shares..................	........0.00		
Issued shares..................................		........0.00	
Common Stock: (Par value $....... per share)			
Authorized shares..................	......0.00		
Unissued shares..................	........0.00		
Issued shares..................................		........0.00	
Total Capital Stock..........................		....	
Surplus: (or less deficit)............................		........0.00	
Total Capital..............................		....	........0.00
(If an individual or partnership)..................		....	
Capital..		....	
Undistributed profits or deficit....................		....	
Total..		....	
Total Liabilities and Capital....................		....	$.......0.00

This statement is subject to our comments upon the examination.

When the Plant, Property and Equipment has been divided so that separate accounts for each asset exist, the preferred form for that section of the statement of condition is:—

PLANT, PROPERTY AND EQUIPMENT

Items	Cost	Reserved for Depreciation	Net Value Carried	
Land............	$............	$..........	$............	
Buildings.........	....	....	....	
Etc.,............	....	....	....	
Etc.,............	....	....	....	
Total........	$............	$..........		$............

EXHIBIT "2"

STATEMENT OF OPERATIONS FOR THE SIX MONTHS ENDED.............
(ENDED, FOR THE PERIOD FROM.......... TO..........)
(OR, FOR THE YEAR ENDED....)

Gross Sales:			
Classify source of income)......................	$.......		
Total Gross Sales..........................		$...0.00	
Deduct:			
All allowances for returns, freight, trade discount, etc.		....0.00	
Net Sales......................................			$...0.00
Cost of Goods Sold:			
Inventory beginning of period.................		....0.00	
Purchases during period......................	....0.00		
Productive labor............................	....0.00		

Cost of Goods Sold (*Continued*)			
Manufacturing expenses, including indirect factory wages	....0.00		
(Classify into insurance, rent, taxes, repairs and renewals, power, etc.)	....0.00		
Depreciation, etc.	....0.00	....0.00	
Total inventory, beginning of period and additions		....0.00	
Deduct:			
Inventory end of period		....0.00	
Total of goods sold			....0.00
Manufacturing profit			....0.00
Selling and Administrative Expenses:			
Separate when possible; selling expense includes shipping material and salaries			
Selling,			
List	$...0.00	....0.00	
Administrative,			
List	....	$.......	
Total selling and administrative expenses			....0.00
Net profit from manufacture			....0.00
Other Income:			
Classify miscellaneous income such as dividends received on securities owned, discount taken on purchases, etc.		....0.00	
Total other income			....0.00
			....0.00
Other Deductions:			
List interest of every description, each discount allowed customers and bad debts to be charged off		....0.00	
Total other deductions			....0.00
Net profit from operations			....0.00
Surplus:			
Beginning of period	....0..0		
Add: Adjustments applicable to preceding period	....0.00	....0.00	
Deduct: Adjustments applicable to preceding period Brought forward	....0.00	....0.00	
Adjusted surplus	....	....0.00	
Dividends:			
Deduct those declared and paid or payable	....	....0.00	....0.00
Surplus end of period—see exhibit "1"			$...0.00

This statement is subject to our comments upon the examination.

Note:—The above outline is for use in manufacturing companies. If used for a jobbing business, the manufacturing costs will be eliminated. In partnerships, a division of profit should replace the dividends. The partners' accounts can be shown on a separate exhibit in the following manner:

EXHIBIT "3"

STATEMENT OF PARTNERS' ACCOUNTS

For the Year Ended December 31, 19......

Capital account of A. B.		
Balance at beginning of Period...............		$0.00
Deduct withdrawals:		
Personal income taxes paid....................	.........$0.00	
Other personal withdrawals...................		0.00
Other personal withdrawals...................	..........0.00	
Total withdrawals.........................		$.........0.00
Balance................................		..........0.00
Add:		
Share of net profits.........................		..........0.00
Balance at end of period......................... (See Exhibit "1")		$.........0.00
Capital account of C. D.		
Balance at beginning of Period................		$0.00
Deduct withdrawals:		
Personal income taxes paid...................	.........$0.00	
Other personal withdrawals...................	..........0.00	
*Interest on withdrawals.....................	..........0.00	
Total withdrawals.........................		..........0.00
Balance................................		..........0.00
Add:		
Proceeds of sale of securities owned by partner..	$.........0.00	
*Interest on additional capital................	0.00	
Share of profits............................	..........0.00	..........0.00
Balance at end of period (See Exhibit "1").........		$.........0.00

******Dependent upon terms of partnership agreement.*

SECTION 3—CHAPTER VIII.

BANK EXAMINATIONS

SAVINGS BANK EXAMINATIONS. The paragraphs immediately following when written were designed to instruct in the examination of a savings bank. Like the commercial examination instructions, the details are complete, even to extremes, and though it is best to make so complete an audit if possible, the extent of the audit must be predetermined by the client, the auditor's obligation to the public ending when he truthfully reports upon what he has examined and clearly states the point beyond which he was not allowed to penetrate.

Much that applies to a savings bank examination, is also a part of any bank examination. Therefore, we are printing the savings bank formula as an entity and later, add variations to provide for other banks.

GENERAL. A bank audit should be commenced either immediately after or before a day's business, preferably the latter.

On entering the bank the accountant should at once take possession of the securities, cash, check books, and pass books of depository banks, and should prepare a statement of the condition of the bank as shown by its books.

If any of the securities owned, or held as collateral, are deposited in outside vaults, the accountant should send a written request, approved by an officer of the bank, to the manager of the vaults, that no one be allowed to open the boxes of the bank, without first notifying him. Securities kept in the vaults of the bank, which the accountant cannot examine at once on entering should be sealed until they can be examined. Until the examination of the securities is finished, all securities, both those which have and those which have not been examined, should be sealed.

No officer or employee of the bank should be allowed to assist in the examination and audit unless so desired by the accountant, who should tell in his statement the extent to which he was assisted by officers or employees.

The accountant should make a complete verification of each item of the assets and liabilities as shown by the general ledger at the date of the audit and the period under examination.

BONDS AND STOCKS. The par and book value of all bonds and stocks should be listed from the subsidiary or individual accounts and should agree in total with the proper controlling accounts in the general ledger. The securities should be examined and checked with the par value shown. It should be ascertained that all unmatured coupons are attached to coupon bonds.

All entries in the general ledger representing bonds, stocks, or notes purchased, paid or reduced in value should be checked to the general ledger, from the cash book or journal; also with the bill of sale furnished by bankers in connection with such transactions, which should be kept on file in the office of the bank.

The accountant should also be satisfied that the "bearer" bonds exhibited are the property of the bank. This can be ascertained only by insisting that the numbers of the bonds purchased shall be specified in the broker's bill of sale and shall be entered in the individual accounts of the respective issues.

LOANS. Each class of notes, when aggregated, should agree with its controlling account in the general ledger. All partial payments of principal endorsed on the notes, and all new loans taken and old loans paid since the last audit, should be checked with the cash book entries.

In the case of mortgage loans the file should be inspected, to see that the mortgage deeds are on hand, properly signed and recorded, and deeds not in the files of the bank should be accounted for through correspondence or otherwise. The accountant should examine and report on the insurance policies, ascertaining that the amount held is sufficient, has not expired, and is payable to the bank in case of loss. If the accountant so desires he may delegate the examination of mortgage deeds and insurance policies to the members of the auditing committee, and their certificate should be annexed to the accountant's report.

Amounts advanced on construction loans should be verified with the receipts given by the borrower or with the canceled checks given in payment by the banks.

Each borrower on collateral security should be requested, with the form on page 67, to verify the date, rate and amount of note and the collateral which the bank holds. Replies should be sent directly to the auditor's office, and should be carefully checked with the collateral found in the bank.

BANK ACCOUNTS. Each depository bank should at once be requested to balance the account of the bank and return to the accountant the envelope or pass book, with the canceled checks, together with a certificate from the cashier of the depository bank showing the balance. With these in his possession, the accountant should reconcile each bank account, and account for items in transit. The dates of deposit credited by the depository bank should be checked with the records of the bank being examined. It is not sufficient to accept a previous statement of a depository bank, as proof of the account on the date of the audit.

REAL ESTATE—BANKING PURPOSES. This account should be examined in the same way as suggested for foreclosed property. If the building is in process of construction or alteration, the contracts and expenditures should be examined. The bank should charge itself with a proper rental for the quarters occupied by it.

EXPENSE ACCOUNT. Vouchers for every expenditure, should be checked with the entries in the cash book or petty expense book, and then canceled in some form satisfactory to the accountant in order to preclude the possibility of again being entered as vouchers.

Vouchers should be numbered or filed consecutively and items charged to this account should represent only the ordinary expense of conducting the business of the bank.

OTHER ASSETS. Changes in these accounts since the last audit should be investigated. Tax receipts and insurance policies on mortgaged properties should be examined so the auditor may be assured that the bank's interests are protected. The auditor should ascertain that the premiums on bonds, carried either in bond accounts or in a premium account, are being reduced semi-annually to correspond with the declining investment value of the bonds.

CASH. After the cash has been counted all checks found in the cash should, under the direction of the accountant, be deposited for collection, with the request that if any are returned unpaid the collecting bank should notify the accountant. Receipts, memoranda and items other than checks, found in the cash should be listed in detail, and the genuineness and propriety of each established. The cash "over-and-shorts" should be investigated, to determine the propriety of the entries.

REAL ESTATE BY FORECLOSURE AND IN POSSESSION. Separate accounts should be kept with each piece of real estate held by foreclosure or in posession, either in the general ledger or an auxiliary book, and the accountant should satisfy himself that the title thereto is vested in the bank. The accountant should examine not only these accounts, but all the original notes, deeds, etc., and all tax or assessment receipts, which represent assets carried on the books. The income and expenses of foreclosed property should be checked with the cash book and the receipted bills, and inquiry should be made as to which estates produce income, and the amount thereof. The assessed values should be obtained and incorporated in the report.

SECURITIES ACQUIRED IN SETTLEMENT OF INDEBTEDNESS. The securities should be examined to ascertain whether any changes in their book value have been made during the period covered by the audit; and if any money has been received from them, either as dividend or interest, or, on account of principal, it should be checked to the cash book. Securities of value not appearing upon the books should be entered thereon at a nominal value as matter of record.

OTHER BANKS. In National Banks and Trust Companies, the same course is followed except that in the cash will be found a greater number of checks which must be traced through the clearing house the following morning. After the examination has commenced and checks that are to clear the next morning are listed, they must remain in the custody of the auditor until delivered, the following forenoon. That is to prevent the substitution of a good check for a bad one, etc. The form of inquiry of the Clearing House Banks is shown on page 63.

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

......................19....

....

....

Dear Sirs:

We are making an examination of the................

.... and find among their assets, drafts or checks upon your institution amounting to $.................

These drafts accompany this letter under our seal, which you are directed to break.

Please advise upon the attached blank if the items aggregating the sum above mentioned are proper charges against you.

Very truly yours,

JOHN BLANK & COMPANY, Inc.

By.........................

Please furnish the information requested.

....

......................19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

Drafts or checks amounting to $............ presented through clearing house with your letter of................. by the..............................are proper charges against us.

Very truly yours,

....

Many notes will be found outstanding for collection, and must be verified by mail. The forms to be used and the course to be followed are:

The form shown on page 63 also accompanies checks found in the cash, to the Clearing House, a representative of the auditor accompanying the messenger to prevent substitution.

On page 67 is the form, already referred to, which is sent to all makers of notes, to prove the genuineness of the notes and the correctness of collateral.

The form on page 68 is sent in order to verify open account deposits or certificates of deposit.

Many banks now operate monthly statements. When they are sent out on the last day of the month, and if the examination is made on the same date, check all balances to the ledgers, add ledgers, enclose the form shown on the top of page 19 and mail the envelopes personally.

When notes belonging to the banks are sent elsewhere for collection, their existence is verified through the forms which appear on pages 69 and 70.

Accounts between banks are checked and reconciled through the use of the form shown on pages 71 and 72.

Pending physical examination of notes, cash reserves, collateral, etc., all of these evidences should be sealed in packages with the seal shown on page 66, on the packages and the vault doors. Seals seldom adhere well to the vault door on account of the cold smooth steel surface. Hence the inner wrapping.

A banker and broker has many accounts with customers who have collateral with him. The blank shown on page 73 should accompany the broker's statement. The latter in turn, must be checked to his books.

INTRODUCTORY LETTER FOR THE CUSTOMARY FINANCIAL EXAMINATION REPORT.

Dear Sirs:

In accordance with your request, we have examined the condition of the...........................as of the close of business.....................................

The results of this examination are presented, attached hereto, together with our comments, in the following exhibits and their accompanying Schedules:

EXHIBIT "1." Statement of condition exclusive of deferred and accrued items as of the close of business...............................

Schedule "A." Securities owned, etc.
EXHIBIT "2." Income and profit and loss account exclusive of deferred and accrued items for period from............................
to the close of business..................

Very truly yours,

JOHN BLANK & COMPANY.

By

C. P. A., M. A. I. A.

New York,
(Date)

THE DEPOSIT NATIONAL BANK

Statement of Condition as of December 10, 1919.

ASSETS

Loans and Discounts:	$	$
Demand..................................	..........0.00	
Time......................................	..........0.00	
Past Due (Schedule "A")...................	..........0.00	
Total loans and discounts		..........0.00
Overdrafts (Schedule "B").......................		..........0.00
Securities owned (Schedule "C").................		..........0.00
Banking house property.........................		..........0.00
Other real estate.............................		..........0.00
Furniture and fixtures..........................		..........0.00
Cash:		
In vault..................................	..........0.00	
Cash items................................	..........0.00	
Items for clearance and collection............	..........0.00	
Total Cash..............................		..........0.00
Due from other banks and bankers................ (Schedule "D")		..........0.00
Federal reserve bank stock......................		..........0.00
Due from treasurer of the United States:		
Bonds to secure circulation..................	..........0.00	
Redemption Fund.........................	..........0.00	
Bonds to secure postal savings fund...........	..........0.00	
Treasury certificates of indebtedness...........	..........0.00	
Total due from treasurer of the United States.		..........0.00
Total assets.............................		$.........0.00

CAPITAL AND LIABILITIES

Capital, surplus and undivided profits:	$	$
Capital..................................	..........0.00	
Surplus..................................	..........0.00	
Undivided profits.........................	..........0.00	
Total capital, surplus and undivided profits...		..........0.00
Circulation....................................		..........0.00
Due to other banks and bankers (Schedule "E")....		..........0.00
Acceptances and bill rediscounted at Federal Reserve Bank....................................		..........0.00

Due to individuals:		
Deposits: Check accounts	..........0.00	
Interest accounts	..........0.00	
Certified checks	..........0.00	
Certificates of deposit	..........0.00	
Cashier's checks	..........0.00	
Postal savings fund	..........0.00	
Total due to individuals		..........0.00
Unpaid dividends		..........0.00
Reserve for taxes		..........0.00
Total capital and liabilities		..........0.00

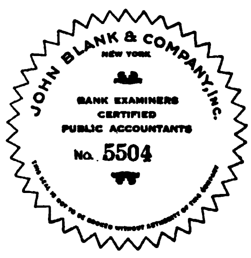
This statement is subject to our comments upon the examination

INCOME AND PROFIT AND LOSS ACCOUNT FOR THE PERIOD FROM..TO..

(See alternative and commercial form)

	$	$	$
Income:			
Interest received:			
(Classify when possible)	....0.00		
Total income		....	
Deductions:			
Interest paid:			
(Classify when possible)	....0.00		
Total Interest Paid		....0.00	
Income for the period before deducting expenses			....0.00
Expenses and General Charges			
Classify		....0.00	
Total Expenses and General Charges			....0.00
Net Income for the Period			....0.00
Balance of Undivided Profits at the Beginning of Period	....0.00		
Add:			
Adjustment items applicable to previous period	....0.00	....0.00	
Deduct:			
Adjustment items applicable to previous period	....0.00	....0.00	
Adjusted Balance Beginning of Period		....0.00	
Dividends		....0.00	....0.00
Undivided Profits (See Exhibit "1")			....0.00

This statement is subject to our comments upon the examination.



JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

......................19....

....

....

Dear Sir:

We are making an examination of the................

....

and find among their assets note...... {endorsed / signed} by you amounting to $................. To enable us to complete our examination and certify to the condition of the bank, will you please acknowledge the existence of the indebtedness upon the attached blank?

Your courtesy will be appreciated.

Very truly yours,
JOHN BLANK & COMPANY, Inc.

Memo: By........................

Following collateral is attached:

....

....

....

....

......................19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

Your statement under date of......................., with reference to note........ and collateral is correct.

....

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

....

....

....

We have been requested by........................
to make a thorough examination of their books and records in behalf of their customers and themselves.

Their records show due...... you at the close of business ....$..............as per the enclosed statement; also that they hold for your account, the securities listed on the statement.

To enable us to complete our examination and to certify to the firm's condition, will you please advise if the amount and securities shown are correct, using the attached blank for that purpose.

Very truly yours,

JOHN BLANK & COMPANY, Inc.

No.......... By.........................

.....................19....

John Blank & Company, Inc.,
New York.

The statement submitted with your letter bearing No............ is correct.

Very truly yours,

....

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

To the Cashier, of the..................................
Treasurer,

You are respectfully requested to forward, at your earliest convenience, to the undersigned, the information asked for in this circular.

This information is requested solely for the purpose of reconciling the account of the within-named bank with your bank at the date of examination of the former.

An addressed and stamped envelope is enclosed for your reply.

Respectfully,

JOHN BLANK & COMPANY, Inc.

By..........................

Please give the information requested:

....

Examination of. .... of. ....

As of Close of Business.......................... 19......

Answers to the following questions are respectfully requested:

1. Did your bank have under discount any bills receivable of the bank named or any on which its official endorsement appeared or for which it was in any other way liable? If so, please furnish a list, giving names and amounts.

1. ....

....

2. Did your bank hold bills receivable or any securities belonging to the bank named, or any on which its official endorsement appeared or for which it was in any other way liable? If any were held, give list and state how they were held.

2. ....

....

3. Were there any loans then outstanding by your bank to the bank named, or to any other party for which the bank was in any way liable? If so, specify character of loan—whether upon bills payable, certificates of deposit, open accounts, or otherwise. In each case specify amount, time, etc.

3. ....

....

4. Had your bank, at said date, effected any loans for account of the bank named? If so, give names of borrowers and amounts, state how the notes were secured and whether or not the security was held by your bank.

4. ....

... .

5. Please state when your account with the bank named was last reconciled.

5. ....

....

....

Cashier.

Treasurer.

Received. ...., 19

The books of the bank under examination show the following items forwarded to your bank for collection, on the dates given. Please verify this list and attest over your signature below the correctness or incorrectness of same.

Date of Letter of Transmittal	Items Enclosed	Amount Enclosed	
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....
....	....	.....	....

.... Cashier.

........................Treasurer.

JOHN BLANK AND COMPANY

Auditors and Public Accountants

New York

To the Cashier, of the.................................
Treasurer,

You are respectfully requested to forward, at your earliest convenience, to the undersigned, the information asked for in this letter.

This information is requested solely for the purpose of reconciling the account of the within-named bank with your bank at the date of examination of the former.

An addressed and stamped envelope is enclosed for your reply.

Respectfully,

JOHN BLANK & COMPANY, Inc.

By.........................

Please give the information requested:

....

Cashier,
To the Treasurer, ...19.....

This statement of the account of the...
rendered at the close of business on....................showing a balance of $...............due from the
....has been examined and
found correct with the exceptions (if any) noted below: ....Cashier.
Treasurer.

DATE						DATE					
		We Debit (not in their Account): Remittances in Transit: They Debit (not on our books): Our Balance.......... Their Balance........						We Credit (not in their Account): Drafts Issued (Outstanding): They Credit (not on our books): Their Balance......... Our Balance...........			

Please fill out the above blank and also report any counter entries appearing on the statement, not shown on your books.

JOHN BLANK AND COMPANY
Incorporated
Auditors and Public Accountants
New York

.....................19....

....

....

....

We have been requested by the Board of Directors of the

....

to make a thorough examination of that institution in behalf of the depositors and stockholders.

The bank's records show due you on.................. the sum of $............ on.......................... To enable us to complete our examination and to certify to the condition of the bank, will you please advise if the amount shown is correct, using the attached blank for that purpose?

If incorrect, please advise in detail.

Very truly yours,

JOHN BLANK & COMPANY, Inc.

No............ By........................

.....................19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

The statement submitted with your letter bearing No... is correct.

Very truly yours,

....

CHAPTER IX.

POINTS TO WATCH IN THE UNUSUAL BUSINESS

THE BILLBOARD BUSINESS. The concern which contracts to place posters or painted signs on billboards presents to the auditor certain peculiar conditions, which, unless he is acquainted with them, he might easily overlook.

All billboard advertising is covered by contracts and to make a comprehensive audit, all of these should be carefully scrutinized to make sure that all of the charges for advertising service whether poster or bulletin, have been charged to the customers.

The principal item of expense to be examined is fence rent. A great number of advertising companies rent space in vacant lots for a stipulated amount per annum. The auditor should make sure that all rent charges are or have been included as part of the cost of operations.

Where the fences or boards are owned by the company, depreciation must be considered. Depreciation depends upon the construction of the board. If a board is constructed entirely of wood, the depreciation should be taken on a basis of 10% per annum, for at the end of ten years, the board will have to be replaced.

The larger companies are spending some money on so-called "metal boards." These boards when thoroughly painted and kept in condition, do not depreciate rapidly, so that a fair estimate for depreciation would be 5% annually.

GAS COMPANIES. In auditing a gas company be sure to consider the sale of residuals developed in the process of making gas. The principal residuals are coke, toluol, holder oil, oxide, ammonia and tar.

Another very important item of revenue is the sale of appliances. The record of these appliances should be carefully gone over and the profit from the sale of them tested out; otherwise an employee may easily enough make a sale, deposit the proceeds in his pocket, and never report the sale. If a

stock record is kept, the auditor should scrutinize the entries for incoming merchandise as well as outgoing.

In past years, it was customary for gas companies to install meters, etc., free of charge, but they now usually make an initial charge. A record of the installation charges should be carefully scrutinized to see that all expense attributable to the jobs has been charged. The amounts as entered in the job register should coincide with the job orders.

Gas companies have two kinds of service; that of the ordinary meter which is read monthly and a bill for the gas consumed rendered accordingly, and the prepayment meter. It is well for the auditor to compare the records of the men who collect the cash from prepayment meters and also to ascertain the districts covered, for one district may contain more meters than another district and naturally the receipts should be greater.

It is often well to suggest, where enough prepayment meters are used to require more than one collector, that the collectors be given different districts now and then. In this way, one will automatically check against the other and if they are in any way inclined to withhold the proceeds, it will serve to catch them very quickly. It was found, by the switching of collectors in one city, that the revenues increased nearly $17,000 although the amount of gas consumed was not greater.

Most gas companies of any size, have their own auditing committees generally made up of the directors. These committees do not as a rule devote the necessary time to a complete examination of the vouchers and records submitted to them for their approval.

Where this is true, it is good practise to examine all data thoroughly even though it has been passed upon by the directors. In one instance every voucher and check had been passed upon by some director who was a member of the examining committee, and yet the cashier was able to abstract several thousand dollars from the concern, by reason of the fact that an alteration was made after the approval of the officer had been obtained. This naturally necessitated a change in the books which tied up the transaction as far as debit and credit were concerned. In several of these cases, it was found that the original record had been altered and such change was passed by a director unnoticed.

Special care should be taken to see that items properly

chargeable to construction are not considered as an expense. Even a pro rata share of executive salaries and expense is applicable to the cost of any new construction which has been considered as legitimate and is allowable by the Public Service Commissions of many states. This, of course, varies from the usual good accounting practise.

WATER COMPANIES. Water companies can be classed as two kinds, natural water pressure and power water pressure.

Natural water companies are usually very small and serve only limited communities. The auditing of such companies is very simple, the principal item of expense being wages. These can be readily checked by a close examination of the payroll. The principal other item is, that of maintenance of both reservoirs and mains. Such companies usually have a flat per annum rate for their water service.

Large companies now as a rule charge for the water actually used as registered on a water meter.

An item worthy of consideration is bad debts. The auditor, in examining a water company's accounts should scrutinize the accounts closely to determine their age. If the water company is owned by the municipality, an account in arrears is sometimes deemed as a first lien upon the property.

MUNICIPALITIES. A municipality has several sources of revenue—taxes, rent, franchises and licenses.

Taxes form the greatest part of the revenue, and the taxes as paid should be checked against the entry on the tax list. Taxes in arrears should also be examined to ascertain the reason for such delinquency, as it has been sometimes found that such a deliquency was a friendly one in that the taxpayer was connected with the municipality's office in some way. These should, if they aggregate a large sum, be brought to the attention of the Common Council.

Rents, franchises and licenses make up a considerable amount of income in the course of a year. As a rule, they consist of renting city-owned property or granting franchises for railroads to run through the principal streets of the town, or the issuance of dog licenses.

While a complete check cannot be obtained of the number of dogs in a village, the comparison of the receipts of one year against another will indicate whether all of the receipts have

been deposited. Another means of check is that of comparing the numbers of the dog licenses issued at the beginning and at the end of the period under review.

It is very often found that the city ties up a considerable amount of its funds for improvements, the assesments for which are not promptly met by the tax-payer. Special attention should be brought to bear on this subject and the auditor should ascertain the reason for the delinquency in meeting these claims, which are a first lien upon the property taxed.

All vouchers for disbursements should be very closely examined, for it has been found that this may be a wonderful melon for grafters. It so often happens that the people elected or appointed to office are purely politicians and have no knowledge of business whatsoever, that often, though they may not be in collusion, bills will be passed or O. K.'d by them which are over-priced. One case was noted where electric light bulbs costing 40c. apiece were paid for by a city at the rate of 85c. each.

A careful scrutiny should be made to see that the sinking fund provisions are fully carried out. In the change of political management from one regime to another, this matter of sinking funds is very often overlooked, as was the case with one city which had issued a twenty year bond with a specified sinking fund provision. It was found that nothing had been set aside or put into such sinking fund, until one year before the bond issued was to be redeemed. When discovered, it had a very dampening effect upon the city's credit and when it had occasion to borrow more money, it had to pay a higher rate of interest.

THEATRES. The audit of a theatre is a cash audit, for tickets are sold for cash, and in many cases, the wages of the employees and actors are paid in cash.

The manner of checking up the receipts depends upon the class of patronage served, that is, whether the theatre shows "10-20-30 continuous performances," or whether it is a theatre which only shows high class productions, the seats of the theatre being numbered, and special tickets being printed for each production and for the specific dates on which the play is shown.

When the theatre is run on the so-called "10-20-30" basis, as a rule, tickets are printed up in rolls. To check up receipts,

the numbers at the beginning and at the end of the rolls should be taken to see that all of the tickets have been used.

When the show is of the other type, as a general rule, they only turn in the number of unused or unsold tickets, together with the cash receipts, and as the seating capacity is always known, it is easy enough to "check up the house." The principal item of expense is that of actors' salaries, followed in order by music, printing and advertising, employees' and stage crew's wages, moving picture rentals if moving pictures are shown, and other general upkeep items.

Booking fees are a very important item. Where salaries are paid to the actors in cash, with a special proviso that a percentage is to be withheld, which in turn is remitted to the actors' booking agents, special notice must be taken that a double entry is not made and that an extra 5% is not added on to the actors' salaries and deposited in the pockets of a dishonest cashier. This was found to be true in one theatre where the cashier obtained a written receipt for the full amount of the salary paid to the actor, while the actor actually obtained only 95%. The receipt was entered as a disbursement for the full 100% and the 5% which was supposedly withheld, was deposited in some other place than the company's bank account. It meant many thousands of dollars a year.

COAL MINING COMPANIES. The principal records to be examined in a coal mine audit are the payroll, sales and cash. The payroll book has embodied in it the wages of all the paid laborers and employees of the company.

Special attention must be given to the classification of the employee, for his wage depends entirely upon this. All matters of compensation are covered by stipulated contract prices; a pick miner receives at present day prices, $1.06 a ton, while a machine miner received 75c. a ton. A machine miner can naturally turn out more coal than a pick miner, and it is not impossible for a machine miner to receive much more than he is entitled to, if he should accidentally be compensated at a pick mining rate.

A great many mines have their own stores through which they supply the miner with all the necessities of life. Such companies as a rule, give credit to the miner generally in sums of $5 or $10 or multiples thereof, depending upon the amount of credit the miner has for coal already mined by him.

These deductions are withheld from the miner's wages, which are paid every two weeks, the miner receiving a net amount after his charges are deducted. The miners very often live in houses built for them by the operating companies, and pay a small rent, which is also deducted. They also use the company coal which is generally sold to them at about cost.

Tests should be made of different payrolls to see that the entries as made are correct and to prove that there can be no collusion.

An important item is that of royalty, especially in connection with concerns operating leased properties. An operating company will contract to pay a certain royalty, generally from 2c to 15c a ton on every ton produced, and further stipulate that it will produce a minimum quantity per annum the royalty on which is payable monthly.

When a mine is newly opened or developed, the production very seldom comes up to the estimated tonnage, so that in a short time, the operator has paid a considerable amount in royalties for which he has received little or nothing. Where this occurs, the royalty cost should be considered as a deferred charge to income, except where a royalty is paid for a piece of property which is held inoperative. Then it is only right that it should be charged off as an expense.

It costs anywhere from $15,000 to $75,000 to develop a mine before any coal can be abstracted. Operators, as a rule, to be conservative consider everything as an expense so that their records usually show a deficit.

This is wrong and where such cases are found, the auditor should take the trouble to make a clear enough analysis to determine the cost of such development work and set it up as a capital item. This does not mean that such a capital item should be allowed to stand there indefinitely.

When the mine begins to produce enough coal to offset the cost of operation, the cost of development should be reduced through amortization. There are many methods of amortizing, but it seems most practical to estimate the tonnage in the tract to be mined and divide the cost by estimated tonnage, thereby getting the tonnage rate. Then, in the succeeding months, the tonnage as mined each month at the estimated rate will give the amount of amortization.

This is very often classified as depletion. It cannot properly be classified as depletion by reason of the fact that when the

land containing the ore is bought for a stipulated amount, a value then exists before the slope or shaft has been put in; but in the case of leasing companies, the money is expended in the development, therefore a distinction is made as between depletion and amortization of development costs.

Depreciation is worthy of consideration. The Government has arbitrarily allowed 10% which, as a whole probably seems to be the fair average, although in some mines a complete mine equipment must be replaced every eight years. The Government only allows 25% on mules, and in the majority of cases, a mule will hardly last more than two years, although where electric equipment is used, a mule may last ten years.

The sales records should be very carefully checked and several tests should be made of the record as against the weight sheets returned by the railroad, for often, even though a difference of 100 lbs. exists, it will run into many hundreds of dollars in the course of a year if the practise continues.

The accounts are generally paid promptly and as most of the coal is sold through coal brokers or jobbers, shipments are seldom more than 45 days old. If claims more than 45 days old appear, reasons for the delay in payment should be ascertained.

FIRE INSURANCE. In auditing the accounts of a fire insurance company, special attention should be paid to the balances due from agents, for as a general rule, the amount of premiums due from such representatives aggregate a large amount, especially when specific agreements are entered into between the company and the agents as to the remittance of the insurance premiums.

Vouchers for all losses should be carefully scrutinized to see that the loss is authentic and that the voucher for payment has been properly authorized. Furthermore, any losses in process of adjustment or settlement should be looked into to see that a reserve for them is set up on the books. If the loss has been settled and the payment has been made at the end of a closing period, the liability should be expressed upon the books as well as in the report.

Insurance companies, as a rule, generally invest their surplus funds in first class securities. These should be carefully examined to see that no defunct issue is carried on the books as a good asset and also that they are not carried above their market value.

PUBLISHERS. When publishers pay royalties, the auditor must examine each royalty contract to determine the method of payment for there is no uniformity in the amount of royalty paid. Some contracts provide that a royalty should be paid on every book printed and bound, even though it may not have been sold. Usually, however, royalties are paid on the number of copies sold. The records should be checked up to verify the copies sold and to see that royalties paid are in accord with the sales record.

Publishers are very apt to ship out their books to book dealers on consignment and to consider such consignments as actual sales. Where this is found to be true, the auditor should correspond with the consignees, ascertain the number of books held on consignment, and adjust the sales account accordingly. If this is not done, then the accounts are misstated, sales are inflated and an anticipated profit is taken on the books.

Magazine publishers get most of their income from advertising. The advertising contracts should be scrutinized to see that all of the stipulations contained therein are fulfilled, the issues published, and that the proper charges are made to the advertisers.

When a magazine is published and sold by annual subscription, the prepaid subscription should be credited to a reserve for income and as each issue is published, 1-12 of the amount received should be transferred from the reserve income account to the subscription income account. To check this, the subscription should be inventoried periodically to see that the reserve account has been properly handled.

AUTOMOBILE DEALERS AND AGENTS. Dealers are ordinarily required to put up a special deposit with the automobile manufacturer as a guarantee of faithful payment for all cars or parts received by them. It is well for the auditor to verify personally these deposits by communication with the manufacturers who have received deposits as shown by the books of the company which is being audited.

Parts, supplies and accessories are the principal stock in trade of the dealer. A very close record of these should be kept, for their value when lost, may amount to a large sum. The small dealer seldom keeps a running inventory of parts and accessories, and as a rule, cannot tell whether he is making or losing money on the sale of them. One concern which sold

parts and acessories amounting to a quarter of a million dollars a year lost money, because it was easy for the salesmen not to report all sales, and to pocket the proceeds.

SPINNING AND KNITTING MILLS. It is important to watch the accounting for the waste which is developed in spinning and knitting mills. It is possible for a fraudulently inclined concern or its executives, to use this as a means of personal profit. The waste developed has a certain value because of the possibility of its use with, or in, so many other products. There are waste concerns which buy every pound of waste developed in the spinning or knitting mills, and by the use of pickers, garnetting machines, etc, are able to make by-products, such as wadding for packing in cushions, etc.

Therefore, the auditor should examine these sales, as the price is generally constant, because a contract is made to cover the supply of waste developed in the mill for a year or more. There should be very little fluctuation in the price.

LUMBER MANUFACTURERS. The accounting of lumber companies in a measure is somewhat similar to that of coal mining. A lumber company generally buys a tract of land for a stipulated amount, or leases the land to cut off the lumber on a royalty basis. When the land is bought outright, and is inventoried among the company's assets, the estimated number of board feet should be obtained, so that the asset can be reduced annually in accordance with the number of board feet cut. The auditor, in examining a lumber company's accounts, should check up the production report to verify it, and to see that the proper reduction in the asset value of the timber land has been made.

The principal item of expense in lumbering is that of labor, as the other expenses, such as lath mills, logging and hauling, planing and other incidental expenses are very small. The payroll book or register should be very carefully audited. As a rule, lumber camps generally have a company store, so that the store accounts should be scrutinized as well. The inventories and stores should be gone over to see that a lot of dead stock is not being carried, which is very apt to be the case when a camp is located far away from any town. The lumbermen usually buy on credit against their wages. These records should be gone over to see that they are correct.

HOSPITALS. As most hospitals are more or less self-supporting, the collection of accounts is an important feature.

A complete history is taken of each patient upon admission, which is entered upon a statistical record in the office. Date of discharge is added when the patient leaves. It would be well for the auditor to compare this record with patients' accounts to ascertain whether each account has been charged with proper duration of stay and class of treatment under which the patient has been admitted. Private, ward, part free and free patients may be common classifications.

Unpaid accounts appearing on the books when patients have been discharged should be questioned. This is often traceable to neglect on the part of the bookkeeper to present the bill at the proper time, which is an important point, as accounts of this kind are difficult to collect after the patient has left the institution.

Treatment for at least one week is usually paid in advance, bills being rendered weekly thereafter. Should a patient not remain the entire week, the difference is refunded in cash. It is well to set up a sufficient amount for petty cash disbursements to meet the payment of refunds, so this item need not be paid from the daily cash receipts.

A customary method of recording cash receipts is in a book consisting of small receipt forms, with perforations between, which are rendered in duplicate, the original being given to the patient and the duplicate remaining in the cash book. A dishonest bookkeeper or cashier may issue a patient's receipt for one amount and book an entry for another. Unpaid balances on accounts may be traceable to such an occurrence.

Extraordinary charges to patients, such as telephone calls, meals for visitors and special nurses, etc., should be carefully checked from the daily record, as hundreds of dollars may be lost for the institution if the bookkeeper fails to make proper charges.

Cash disbursements should be most carefully checked against the invoices representing them. Too often the individual or board of managers who passes invoices for payment does not know whether bills are legitimate or not, much being taken for granted.

Standard Paragraphs
for
Audit Reports

INDEX TO CAPTIONS

SECTION IV.

HOW TO USE THE STANDARD PARAGRAPHS

These standard paragraphs have been drawn up for two purposes; first, to save time for accountants in writing the comments of a report, and second, to make sure that each comment will be accurately and clearly expressed.

We reproduce a single example of introductory letter. It is not our idea to standardize the wording of these, and this one is reproduced solely as a model. The language used in each instance may well be varied.

It is obviously impossible to write beforehand paragraphs which will cover every conceivable comment. The attempt has been made in this book, however, to cover all of the usual ones. The auditor is expected to use such of these as fit and then to write such other paragraphs as the special case calls for. It is only necessary to specify the paragraph needed by number; writing in any other information that seems essential. The comments then go to a stenographer who, by referring to her copy of this book, writes out the comments in full and sends them to the printer.

On page 88 is a sample set of comments as they might be turned in by the auditor. On page 89 is the report as typed by the stenographer from the auditor's notes.

Note that it is necessary for the auditor to write in the caption in each instance; this because the same caption must sometimes be stated differently as in the 100 series, where it may be necessary to use any one of the four captions, "Fixed Assets," "Plant and Equipment," "Land, Buildings and Machinery," or "Land, Buildings, Machinery and Equipment."

Also it is at times necessary to insert a key word. For example, in using paragraph 600, the auditor should write either one of the words "depository" or "depositories" to show the typist which to use.

Another instance comes in paragraphs like 601, where a blank space is left for the date or other insertion. To use such a paragraph, the auditor would write for example, "CASH IN BANK—601—depository—Jan. 1, 1919."

<u>Fixed Assets</u> 100 - 101 - 107

107

Asset	Percentage of Cost	Amount Reserved for Depreciation
Buildings	3%	10,000.00
Machinery	10%	50,000.00

107 "inadequate"

Owing to the overtime operations for the period under review, it is apparent that the ordinary 10% depreciation can hardly compensate for the extra-wear on machinery under the increased burden of a 24 hour day. We therefore recommend the additional charge of the amount of $25,000.

<u>Investments</u> 201. Schedule A. profit - 202

<u>Accounts Receivable</u> 300 - 301 - 302 - 303

This is the way the auditor sends his report comments in to the office. They are in longhand, using the standard paragraphs as far as possible. Where needed he fills in words or figures and adds such comments as are not covered by the printed paragraphs. On the opposite page and on page 90, the comments are shown as they would appear in the printed audit report, after having been "translated" from the longhand notes above. The comparison shows clearly how much work is saved by the auditor who uses standard paragraphs. The quality of English and the clearness of the report is also improved.

"FIXED ASSETS: These assets are carried on the books at original cost with offsetting reserves for depreciation to provide for wear and tear and obsolescence. On the statement of condition we have applied the reserves for depreciation against the respective costs and extended the net book value as the asset value.

"Upon reviewing all charges to these accounts during the period covered by our examination, together with all vouchers supporting such entries, we found that none but capital expenditures were included.

"The following amounts credited to reserve for depreciation accounts, and charged to operations for the period, represent the stated percentages of the cost of the respective depreciating assets:

ASSETS	Percentage of Cost	Amount Reserved for Depreciation
Buildings.................	3%	10,000.00
Machinery................	10%	50,000.00

"We believe the amounts so reserved to cover wear and tear and obsolescence for the period are inadequate.

"Owing to the overtime operations for the period under review, it is apparent that the ordinary 10% depreciation can hardly compensate for the extra wear on machinery under the increased burden of a 24 hour day. We therefore recommend the additional charge of the amount of $25,000.

"INVESTMENTS: The securities are carried on your books at cost. We have not made any adjustments to bring the book value into agreement with current market values, although, as indicated on Schedule "A" a profit would result from the sale of the securities. Federal Tax Law Regulations do not recognize a profit or loss on securities until a bona fide sale is made. This is in agreement with good accounting practise.

"We examined, at your depository, the Liberty Bonds carried on your books. We have applied against the par value the amount of notes held by the bank and the amount received from employees on account of their subscriptions.

"ACCOUNTS RECEIVABLE: A listing of the balances appearing in the individual accounts proved the accuracy of the

amount shown on our statement of condition. We did not correspond with your debtors for the purpose of verifying the amounts shown to be due from them. By thorough tests of postings from books of original entry affecting accounts receivable, we established the clerical accuracy of the accounts. By the time our examination was completed substantially all of the accounts open at the close of the period under review had been paid.

"We noted, however, that after payment by the debtors, small balances remained in several of the accounts. In the majority of instances they represent items in dispute, such as claims, returns or cash discounts.

"We suggest that a member of your staff be assigned to the duty of taking items up for adjustment and write off the accounts which do not reflect a possibility for collection."

The 100 series of paragraphs may be used under any of the following captions: "Fixed Assets," "Plant and Equipment," "Land, Buildings and Machinery," "Land, Buildings, Machinery and Equipment."

These assets are carried on the books at original cost with off- 100
setting reserves for depreciation to provide for wear and tear and obsolescence. On the statement of condition we have aplied the reserves for depreciation against the respective costs and extended the net book value as the asset value.

Upon reviewing all charges to these accounts during the period 101
covered by our examination, together with all vouchers supporting such entries, we found that none but capital expenditures were included.

By carefully scrutinizing all charges to these accounts during the 102
period under review, it was determined that no items properly chargeable to operations were included.

Under this caption on the statement of condition, we have set 103
forth the cost values carried in the ledger for the respective accounts, applied against them amounts set up as reserve for depreciation and carried the balance out as the net book value. All charges to these accounts during the period were supported by properly authorized invoices of the vendors. No items properly chargeable to operations were included in those charges.

There were charged to your operating accounts and credited 104
to reserve for depreciation account, amounts which in our opinion, adequately cover wear and tear and obsolescence for the period.

We strongly recommend that your reserve for depreciation 105
account be analysed and the amounts reserved for depreciation ot different classes of assets (such as buildings, machinery, etc.) be set up in separate reserve accounts.

This practise would permit the ready determination of the net 106
book value of any class of fixed asset at any time. Furthermore the regulations and rulings of the Commissioner of Internal Revenue require that such information be available for the correct preparation of Federal Tax Returns.

The following amounts credited to reserve for depreciation 107
accounts, and charged to operations for the period, represent

the stated percentages of the cost of the respective depreciating assets:

ASSET	Percentage of Cost.	Amount Reserved for Depreciation

We believe the amounts so reserved to cover wear and tear and obsolescence for the period are (adequate—inadequate.)

108 The deeds to your property, together with the County Clerk's certification that proper recording had been made, were examined and found to be in order. We also examined, and found satisfactory, title insurance policies covering the property.

109 We have shown the value of land and buildings separately on the statement of condition. Buildings depreciate in value through wear and tear but plant land does not. The true book value of the depreciating asset is more readily ascertained by separation of the accounts and application of the reserve for depreciation against the account affected. We recommend that the land and buildings account be separated on your books.

During the period under review additions to your fixed asset accounts amounted to:

ASSET	Amount (*List amounts without consideration of reserve for depreciation*)

110 All of the entries covering these increases were carefully scrutinized, together with the vouchers supporting them, and found to be capital charges.

111 The reserves for depreciation were increased by the amount of \$.......... during the period. The following are the yearly rates of depreciation applied and the amounts set aside as representing the wear and tear and obsolescence for the year for the respective classes of assets:

ASSET	Yearly Rate	Amount Reserved for Depreciation

112 These entries resulted in a net (increase—decrease) for the period of \$.......... in the net book value of your fixed assets. We believe that the amounts reserved for depreciation adequately cover the wear and tear and obsolescence of your properties.

113 The scope of our examination precluded analysis and verification of all entries in your capital accounts from the date of

their inception. We believe, however, that the values carried reflect the cost of the original properties and subsequent additions.

An appraisal of your properties by........(Name).......... under date of............(Date)............ affords the following favorable comparison of current replacement values with the net book values as of ....(date)............ 114

ASSETS	Replacement Value	Net Book Value

As the difference between the appraised value and the net book value represents an unearned increment, and good accounting practise precludes its recognition as a profit of the business, the statement of condition reflects the net book values only. 115

We note with approval that you have not carried into your books of account the value placed upon your properties by ....(Name)........ in an appraisal dated............. The comparison between the appraised value and the net book value is favorable to your company. Good accounting practise, however, precludes recognition of a profit until a sale is made. Any enhancement in value indicated by an appraisal should be recognized chiefly for insurance purposes but should not be reflected in the books of account. We show below a comparison of the appraised values with the net book values as of ....(Date)............. 116

ASSET	Replacement Value	Net Book Value

To be used for special investigations only.

We recommend that you discontinue the present practise of writing down the value of your depreciable assets by the amount of depreciation charged to operations. You are using fixed annual depreciation rates against the balances appearing in the accounts which results in a smaller proportion of the original cost being written off each year. The best practise requires that the original cost of the assets be retained in the accounts while the yearly depreciation provision is credited to a reserve for depreciation. Under this practise the reserve for depreciation would be sufficient to amortize the original cost of the asset completely at the expiration of its estimated life. 117

118 We examined the deed to your property and found the County Clerk's certification that proper recording had been made in the name of your institution. We also found that you are protected by a title insurance policy.

119 As requested, we undertook to verify the accuracy of the assets and liabilities carried on the books of account and to certify that all assets owned by the company are presented at a true "going concern" value. All valid ascertainable liabilities are correctly included in our statement of condition. We recite below the extent of, and relevant comments upon, the various phases of our examination.

We examined, and found in order, the securities carried in your investments account. Your income account reflected proper credit for interest and dividends earned during the period. Interest accrued but not received at the date of closing is carried as a current asset. 200

Note.—If the securities were all bonds or all stocks, changes should be made in the above paragraph accordingly.

The securities are carried on your books at cost. We have not made any adjustments to bring the book value into agreement with current market values, although, as indicated on Schedule ...., a (profit—loss) would result from the sale of the securities. Federal Tax Law Regulations do not recognize a profit or loss on securities until a bona fide sale is made. This is in agreement with good accounting practise. 201

We examined, at your depository, the Liberty Bonds carried on your books. We have applied against the par value the amount of notes held by the bank and the amount received from employees on account of their subscriptions. 202

800 A listing of the balances appearing in the individual accounts proved the accuracy of the amount shown on our statement of condition. We did not correspond with your debtors for the purpose of verifying the amounts shown to be due from them. By thorough tests of postings from books of original entry affecting accounts receivable, we established the clerical accuracy of the accounts.

801 By the time our examination was completed substantially all of the accounts open at the close of the period under review had been paid.

802 We noted, however, that after payment by the debtors, small balances remained in several of the accounts. In the majority of instances they represent items in dispute, such as claims, returns or cash discounts.

803 We suggest that a member of your staff be assigned to the duty of taking these items up for adjustment and write off the accounts which do not reflect a possibility for collection.

804 We investigated these exhaustively and found them to be in good condition. Aside from listing the detailed accounts and proving against the total shown on the statement of condition, we prepared and mailed statements to all debtors with a printed inquiry, so worded, that we would be advised of any discrepancies through our own office. The exceptions taken were few in number and consisted of only the customary questionings of trifling claims, discounts and other items of the type frequently disputed.

805 Any necessary concessions will, we believe, be adequately covered by the reserve for bad debts established.

806 We proved the accuracy of the amount shown on the statement of condition by listing and totaling the detailed accounts. A thorough test of postings from the books of original entry was made. We did not, however, correspond with the debtors to verify the authenticity of the accounts.

807 Except for the items listed in Schedule .... the accounts were all of recent origin.

808 From the tenor of replies to inquiries directed to your debtors, requesting verifications of the balances shown on your books,

we believe your books correctly reflect the trade accounts receivable. The minor exceptions taken represent chiefly claims, discounts and similar items commonly in dispute.

We carefully examined the detailed accounts and found them to be in good condition. The comparatively few past due accounts indicate care and conservatism in the extension of credit. 309

A listing of the balances appearing in the detailed accounts and exhaustive tests of postings from books of original entry revealed no discrepancies and assured the clerical accuracy of the work. 310

We did not, however, verify the balances carried on the books by correspondence with the debtors. 311

We found numerous small credit balances appearing in your accounts receivable and have set them up as liabilities on our statement of condition. We believe it to be good practise to clear these items periodically by remitting amounts standing to the credit of customers. 312

On Schedule .... we have classified your accounts according to the length of time they have been on the books. Although some of them are past due we believe them to be good and do not feel that you would be justified in writing them off. 313

Accounts amounting to $.......... were written off to profit and loss during the period. We found that every reasonable effort had been made to collect those accounts. The amount, however, is but a small percentage of your sales for the period which indicates care in the extension of credit. Accounts past due, but considered good, were being followed up vigorously for collection. 314

400 We examined the notes represented by this account and found the total to be in agreement with the amount shown on our statement of condition after considering the notes paid during the period between the date of the statement and the date of our visit.

401 The notes representing this account were examined and found to be in order. We are attaching a schedule of the notes as part of this report.

402 In support of the amount shown on our statement of condition, we are attaching a schedule of notes receivable. Notes maturing between the date of our statement and the date of our visit were checked for cash receipts or renewals. The balance of the notes were examined and found to be in order.

403 Notes maturing after the date of our statement and prior to our visit were checked for proper cash receipt. We obtained acknowledgement from your bank that the balance were in their hands for collection.

404 The notes represented by this account matured and were paid between the date of our statement and the date of our visit.

405 We have verified the balance representing this account. Notes maturing between the date of our statement and the date of our visit were checked for cash receipt or renewal. The remainder of the notes were examined and found to be in order, excepting those in the hands of your bank for collection. In verification of the latter we obtained an appropriate certificate from the bank.

The values stated in our statement of condition represent inventories taken by your representatives as of the close of the period. After carefully testing prices, footings and extensions to assure ourselves of the clerical accuracy of the work, we accepted the figures. 500

As we were not represented at the time the inventories were taken, we had no opportunity to verify the count. We did, however, test the prices applied to the major items listed, together with extensions and footings, and assured ourselves of the clerical accuracy of the inventories. 501

We have accepted the inventories prepared by your staff. The extent of our verification was to test the prices, extensions and footings appearing on the inventory sheets. We in that way satisfied ourselves as to the clerical accuracy. 502

We were not represented at the time your inventories were taken but accepted your figures after exhaustive tests of the extensions and footings. We also tested the prices applied against the major items and found them to compare with market values as of the date of the inventories. 503

On ....(Date)........ physical inventories of the raw material, goods in process and finished stock were taken, togather with an inventory of the other supplies. We assigned ......(Number)...... representatives to aid in the actual count and tabulation of the articles. ....(Number).... of those representatives, to whom we assigned the more difficult tasks, have been for years intimately associated with the industry. 504

Pricing was done at cost or market, whichever was lower in each case. Goods in process and finished goods were extended at conservative cost figures. The mathematical accuracy of extensions and footings was thoroughly tested. 505

Our representatives were present at the time the physical inventories were taken and assured themselves of the accuracy of the count by thorough tests. The extensions and footings were also carefully tested. We, accordingly, believe that the figures stated correctly reflect the value of the inventories as of the date of our statement. 506

Note—Indicate when using the following paragraphs whether the singular or plural form of "bank" and "depository" is to be used.

600 After taking into consideration all outstanding checks, we reconciled your cash account with the balance certified to by your depository. All checks were examined for proper endorsement and checked into the books of entry.

601 We secured from your depositories, certificates of balances as of ....(date).... which, after deduction of outstanding checks, reconciled with your cash account. All canceled checks were scrutinized as to proper entry and endorsement.

602 We obtained certificates of balance, as of the date of our statement, from the company's depositories, which, after considering outstanding vouchers, we found to be in agreement with the records.

603 Statements were received from your depositories certifying to the balances on hand to your credit as of .... (date)...., which after consideration of outstanding checks agreed with the ledger accounts.

The cash and vouchers on hand at the time of our visit proved to be in agreement with the records. 700

Our representative counted the cash and vouchers on hand and found the total to be in agreement with the ledger. 701

This was counted by our representative, and, after consideration of unentered receipts and disbursements, the balance agreed with the amount shown on your records. 702

We suggest that the "imprest cash" system be adopted. An amount sufficient to cover requirements for a period should be charged to the cashier and he would be required to have that amount in cash or cash and vouchers on hand at all times. The fund should be reimbursed by the actual amount of disbursements as occasion may require. 703

It was found that receipts from cash sales were passed through your petty cash. We suggest that such receipts should be credited through the regular cash book and deposited daily with other cash receipts. 704

800 The accounts under this caption represent expenses paid or accrued in the period under review but which are properly applicable to the operations of subsequent periods.

801 The amounts shown under this caption represent the proportion of expenses, paid or incurred, in the period covered by our examination, chargeable to a subsequent period.

802 Of the expenses paid or incurred during the period under review we have set up, under this caption, the proportion properly chargeable to subsequent operations.

803 We examined the insurance policies and found the value carried as "unexpired insurance" to be a correct proportion of the premium paid.

804 The amount carried for "interest paid in advance" was obtained by prorating discount on notes discounted over the period covered by the notes.

805 We examined the insurance policies and found the value carried as "unexpired insurance" to be a correct proportion of the premiums paid.

806 Upon examination of the unexpired insurance policies, we found the balance, as shown on our statement of condition, to be correct.

807 We found the proportion of insurance premiums properly chargeable to subsequent periods to be correctly set forth on the books.

Your capital stock records were examined and the amount of outstanding certificates indicated thereon reconciled with the amount shown on our statement of condition. 900

We checked the capital stock certificate stubs and found that the amount of the capital stock issued and outstanding agreed with our statement of condition. 901

We found that the required Federal Tax stamps were affixed to the certificate stubs and canceled. 902

All certificates turned in for transfer were attached to their respective stubs and properly canceled. 903

The minute book was scrutinized and found to provide authorization for dividends and salaries paid. 904

We examined the minute book and found therein proper authority for the payment of dividends and officers' salaries. 905

Of the authorized capital stock, $.......... has never been issued. This is reflected on our statement of condition as "unissued stock." We found, however, that the amount is being carried in your books of account as "treasury stock." The latter term is applied to stock, which, after being issued for legal consideration, is returned to the treasury by purchase, donation or otherwise. As the amount of stock mentioned has never been issued we firmly recommend that it be transferred to an "unissued capital stock" account. 906

1000 Appended to our statement of operations is a reconciliation of the surplus account as of the beginning and end of the period under review.

1001 The items affecting the surplus account are detailed in the reconciliation of that account appended to our statement of operations.

1002 We have stated in detail, at the end of our statement of condition, the items affecting the surplus account during the period.

1003 By foot notes on our statement of condition and statement of operations we have called your attention to the fact that the surplus is subject to a deduction for Federal Income and Excess Profits Taxes, for which no reserve had been created. As the amount of tax payable had not been definitely computed at the time of our visit, we thought it inadvisable to convey a possibly misleading conception of the condition of the business by charging surplus with an estimate of the tax.

The reserve for discount on our statement of condition was created for the purpose of charging against the profits for the period the probable amount of cash discounts that will be allowed at the time your accounts receivable are liquidated. The creation of this reserve results in more accurately stating the liquidating value of the accounts receivable: 1100

The amount reserved for bad debts appears to be ample to meet possible losses from uncollectable accounts. 1101

The reserve for discount was created to take care of probable cash discounts to be taken on accounts receivable. Although the date of remittance for the balances due from trade debtors cannot be foretold, analysis of past collections indicates an average cash discount of .... per centum will be taken. We have accordingly applied that percentage against the amount of accounts receivable in determining the amount to be reserved. 1102

The reserve for bad debts appears to be of sufficient proportions to provide for possible contingent losses from uncollectable accounts. The ratio of reserve to accounts receivable is greater than losses from that direction suffered in the past. 1103

The reserve for Federal Income and Excess Profits Taxes was created on the basis of the Federal Taxes for the period as computed by our Tax Service Department. 1104

Our Tax Service Department supplied the amount used in creating the Reserve for Federal Income and Excess Profits Taxes. 1105

The Reserve for Federal Income and Excess Profits Taxes was created on the basis of the tax as computed at the time of our visit. It is subject, however, to any corrections that may be made between that time and the date of filing the return. 1106

The Reserve for Federal Income and Excess Profits Taxes is in agreement with the amount of tax payable as stated on your return filed with the Collector of Internal Revenue. 1107

We examined these accounts and believe them to be adequate to meet any contingency, which may reasonably be expected to occur, in connection with the transactions for the period under review. 1108

1109 The reserve for taxes, other than Federal Taxes, is based upon last year's tax rates. The amount reserved is the proportion of the estimated tax chargeable to the period under review.

No trade paper is included in this amount, the notes representing accommodation extended by your depositories. Certificates obtained from them verified the accuracy of your records. 1200

By corresponding with the payees listed on your notes payable record we verified the accuracy of the amounts due those creditors. 1201

We corresponded with all note-holders listed on your records and, without exception, received their acknowledgments that the amounts stated represented the amount of your notes held by them. 1202

A schedule of the notes, as they appear upon your records, accompanies this report. 1203

Our verification of the amount stated as your liability for notes payable was limited to a careful check of all entries in your records affecting that account. 1204

The amount of outstanding notes was verified by checking all entries affecting the account and examination of notes paid and canceled. We did not correspond with the recorded holders of your notes for the purpose of verifying outstanding obligations of that nature. 1205

Your record of notes and trade acceptances payable was checked and the total of the outstanding obligations listed therein was found to be in agreement with the balance appearing on our statement. We did not attempt to verify the items by correspondence. 1206

On Schedule ......we have listed your outstanding notes as they appear upon your records. 1207

According to the information appearing in your records, the following were the notes outstanding as of the date of our statement: 1208

Date Issued	In favor of	Date due	Amount

The following notes were outstanding as of the date of our statement: 1209

Date Issued	In favor of	Date due	Amount

1300 We did not undertake to verify by correspondence the accuracy of the liabilities carried in your open accounts. We scrutinized the balances appearing in the individual accounts and found the total to be in agreement with the control account balance appearing on our statement of condition.

1301 The balances appearing in the individual accounts were examined and their total found to agree with the balance in the controlling account listed upon our statement. We did not attempt verification of the balances by correspondence with the creditors.

1302 The scope of our examination satisfied us that all items included in the inventory were properly reflected in this liability.

1303 A listing of all invoices entered in your (charge register—voucher register—accounts payable register) and unpaid at the close of the period agreed in total with the balance carried in the controlling account appearing on our statement.

1304 We examined the invoices and checked them into the record for proper entry and distribution. We did not undertake to verify the accuracy of the record by correspondence with the creditors, but are satisfied that the amount stated correctly reflects your liability on open accounts.

1305 We did not correspond with the creditors for the purpose of verifying the amounts due to them on open accounts. The balance shown is that appearing upon your records, the underlying detail of which we thoroughly tested.

These items were set up in order that all incurred charges to 1400
the operations of the period might be properly included. The entries were examined and found to be correct.

We examined the entries to these accounts and found them 1401
to reflect correctly accrued items of expense properly chargeable to the period under review.

1500 We thoroughly examined the detail in the books of original entry, verified the footings and checked the results into the general ledger. The accounts in the ledger were in turn footed and the accuracy established.

1501 All disbursements for the period were carefully examined. Canceled checks supporting the disbursements were checked against the entry in the record and examined for proper endorsement. Payrolls were examined and thoroughly tested for accuracy of footings. No attempt was made to verify the authenticity of names and amounts entered on the payrolls.

1502 The canceled checks for the period were checked against the entries in the cash disbursement record and further examined for proper endorsement. We scrutinized the pay rolls and established the accuracy of the footings by thorough tests. The names and amounts appearing on the payrolls were, however, accepted without an attempt at verification.

1503 Verification of the accuracy of payrolls is one of the most unsatisfactory tasks confronting a public accountant. The executive must chiefly rely upon the efficacy of a well devised system of internal checks. The occasional assignment of a competent employee, in no way connected with the preparation or disbursement of payrolls, to be present when the payroll is prepared and disbursed, together with a close follow up on unclaimed wages, might well merit your attention.

1504 We also made a thorough examination of all disbursements. Canceled checks were matched against their corresponding entries in the cash book and also examined for proper endorsement.

1505 In the course of our examination all books of original entry checked and footed, the entries then being followed through to the general ledger for verification of correct entry. The general ledger was in turn footed and the accuracy of the accounts thereby established.

1506 The accuracy of your books of accounts was established by examining the entries in the books of original entry, checking them into the general ledger to see that the appropriate accounts were affected and by verifying the accuracy of footings in the ledger and subsidiary records.

We made a detailed examination of the books of original entry and traced the postings of the entries into the general ledger. The accuracy of all footings was established. 1507

We also made a thorough check of the entry of invoices for purchases and expenses. Beyond a cursory examination of each invoice we did not attempt to verify the accuracy of the mathematical computations appearing thereon. 1508

The purchase invoices in your files were checked into the books of original entry, care being taken that the proper accounts were affected. 1509

Invoices supporting purchases and expenses for the period under review were examined and checked into the book of original entry. 1510

The footings in the books of original entry were verified and checked into the respective ledger accounts which in turn were re-footed and proved. 1511

We verified the accuracy of the footings in the books of original entry and checked the entries into the general ledger, the accounts in which were later re-footed and proved. 1512

In place of the present practice of making entries in the journal without the review and approval of an executive we recommend that a form of journal voucher be used which would require the review and approval of an executive before entry. 1513

We do not believe that you are getting the maximum of value from your accounting records in the way of monthly statements and reports. Comparative statistics are of inestimable value to a busy executive and we have in mind several that could easily be prepared by your accounting organization. We would be pleased to outline these specifically upon request. 1514

1600 We wish to express our appreciation of the many courtesies extended to our representatives by your executives and office staff during the examination.

1601 Our representatives were extended cheerful assistance and hearty cooperation by your staff during the conduct of the examination.

1602 We found the accounts to be well kept and wish to express our appreciation for the many courtesies extended to our representatives during the period devoted to our examination.

1603 Our representatives again found it a pleasant duty to conduct the examination at your office. We desire to express our appreciation of the courtesies extended to them.